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BARRIERS TO ENTRY STUDY

April 1992

FINAL REPORT

VOLUME I
MAIN REPORT

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PREFACE

This study examines the types and effects of entry barriers in the Philippines. The United States Agency for International Development (USAID) has commissioned SGV Consulting to undertake the study in order to develop background information on entry barriers in the country, and propose policy recommendations that will help remove these barriers or minimize their negative effects.

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LIST OF ACRONYMS

ABI	Asia Brewery Incorporated
ADB	Asian Development Bank
AFTA	Asean Free Trade Area
APT	Asset Privatization Trust
ASEAN	Association of South East Asian Nations
BAI	Bureau of Animal Industry
BAP	Bankers Association of the Philippines
BFAR	Bureau of Fisheries and Aquatic Resources
BOI	Board of Investments
BOT	Build-Operate-Transfer
BP	Batasang Pambansa
CAB	Civil Aeronautics Board
CB	Central Bank
CBU	Completely Built Units
CDP	Car Development Program
CEPT	Common Effective Preferential Tariff
CKD	Completely Knocked Down
COP	Committee on Privatization
DBP	Development Bank of the Philippines
DE	Disposition Entities
Digitel	Digital Telecommunications Philippines, Incorporated
DOF	Department of Finance
DOH	Department of Health
DOJ	Department of Justice
DOSRI	Director-Officer-Stockholder and Related Interests
DOTC	Department of Transportation and Communications
DTI	Department of Trade and Industry
ECC	Energy Coordinating Council
EO	Executive Order
ERB	Energy Regulatory Board
ERP	Effective Rate of Protection
ETPI	Eastern Telecommunications Philippines, Incorporated
FIA	Foreign Investments Act
Filsyn	Filipinas Synthetic Fiber Corporation
FPA	Fertilizers and Pesticides Authority
GC	Government Corporations
GFI	Government Financing Institution
GNP	Gross National Product
GSP	Generalized System of Preferences
GTEB	Garments and Textiles Export Board
HB	House Bill
HULRB	Housing and Urban Land Use Regulatory Board
IBP	Interim Batasang Pambansa
IMF	International Monetary Fund

IPP	Investments Priorities Plan
ISA	Iron and Steel Authority
IV	Intravenous
KBL	Kilusang Bagong Lipunan
LBP	Land Bank of the Philippines
LDP	Laban ng Demokratikong Pilipino
LGU	Local Government Unit
LIC	Lakeview Industrial Corporation
LOI	Letter of Intent
LPC	Luzon Petrochemical Corporation
LTFRB	Land Transportation Franchising and Regulatory Board
MARINA	Maritime Industry Authority
Meralco	Manila Electric Company
Napocor	National Power Corporation
Nasutra	National Sugar Trading Corporation
NEDA	National Economic and Development Authority
NFA	National Food Authority
NGO	Non-Government Organization
NIE	Newly Industrialized Economies
NLRC	National Labor Relations Commission
NSC	National Steel Corporation
NTC	National Telecommunications Commission
ODA	Official Development Assistance
PAL	Philippine Airlines
Paptelco	Philippine Association of Private Telephone Company Operators
Patent Bureau	Patents, TradeMarks, and Technology Transfer Bureau
Pb	Price, border
PC-FEU	Philippine Constabulary - Firearms and Explosives Unit
Pd	Price, domestic
PDP-Laban	Philippine Democratic Party - Lakas ng Bayan
PCCI	Philippine Chamber of Commerce and Industry
PCIA	Philippine Cement Industry Authority
PCMP	Progressive Car Manufacturing Program
PD	Presidential Decree
Philcemcor	Philippine Cement Corporation
Phinma	Philippine Investment and Management Company
PICOP	Paper Industries Corporation of the Philippines
PIDS	Philippine Institute for Development Studies
PLDT	Philippine Long Distance Telephone Company
PNB	Philippine National Bank
PNOC	Philippine National Oil Company
PSC	Price Stabilization Council
PSCC	Philippine Standard Classification Code
PSIC	Philippine Standard Industrial Code
R&D	Research and Development
RA	Republic Act
RAGC	Republic-Asahi Glass Corporation
SB	Senate Bill
SCPP	Structure-Conduct-Performance Paradigm
SCRA	Supreme Court Reports Annotated

SEC	Securities and Exchange Commission
SGV	Sycip, Gorres, Velayo and Company
SKD	Semi-Knocked Down
SMC	San Miguel Corporation
SRA	Sugar Regulatory Administration
Unicom	United Coconut Oil Mills
UNIDO	United Nations Industrial Development Organization
UP-PGH	University of the Philippines - Philippine General Hospital
USAID	United States Agency for International Development
USIFE	USI Far East Corporation
VAT	Value Added Tax

EXECUTIVE SUMMARY

BACKGROUND

The United States Agency for International Development (USAID) Philippines has commissioned SGV Consulting (SGV) to undertake an exploratory study on barriers to entry in the Philippines. The engagement is aimed at (a) developing background information on entry barriers in the country, and (b) proposing policy recommendations to remove these or minimize their negative effects.

Despite structural adjustment efforts since the early 1980s, the Philippine economy remains vulnerable to shocks, and long-term growth appears fragile. One reason is that structural reforms designed to induce competition and enhance competitiveness are impeded by barriers at the microeconomic level.

Overall, discussions on entry barriers theorize that various elements of the industry structure can impose disadvantages on new competitors that are not borne by existing players. Bain (1956) mentions three sources of advantage to existing players: (a) scale economies, (b) product differentiation, and (c) absolute cost advantages. Porter (1979) adds three more: (a) capital requirements, (b) access to distribution channels, and (c) government policy.

In a dynamic sense, barriers can be viewed as a reality in competitive markets. Enterprises seek to sustain their competitive advantage through product development, brand differentiation, market diversification, creation of distribution networks, or similar moves that would keep their rivals out. Potential entrants, on the other hand, strive to break down these barriers through innovative strategies of their own.

As entry is one of the principal forces of competition, the constant erection or dismantling of barriers results eventually in improved resource allocation and use and in enhanced consumer welfare.

Often, however, barriers reflect noncompetitive or anticompetitive situations. This is so when barriers are set up because of inappropriate government intervention or the rent-seeking activities of certain groups. Such barriers to entry persist in the Philippines and tend to weaken and hamper adjustment efforts.

Microeconomic/industry reforms are therefore necessary to complement and sustain current and future structural changes in the economy. Conversely, macroeconomic stability is needed to enhance the effectiveness of microeconomic reforms.

In this regard, the Barriers to Entry study is opportune as it brings out policy issues that, it is hoped, will lead to deeper analysis and the adoption of the needed microeconomic reforms.

SCOPE OF WORK

The Barriers to Entry Study looks into the following interrelated areas: theoretical issues related to entry barriers; adjustment reforms and Philippine market structures; legal framework, policies, and programs; administrative arrangements; and political economy issues. It then proceeds to identification of policy-induced and structural entry barriers and assessment of their effects. The goal is the formulation of a policy and research agenda that will enhance liberalization, deregulation, and industry competitiveness, in support of the structural changes that have been taking place since 1980.

The study takes both positive and normative approaches. The positive approach seeks to describe market and industry structures in the Philippines, find out which entry barriers exist, and determine whether these are policy-induced or structural in nature. The normative approach assesses the effects of these barriers on users, the dominant firm(s), competition, and government development objectives, and considers impact on overall competitiveness and efficiency. The study then proposes reforms to foster competition and improve competitiveness.

The study takes both a micro and a macro view of barriers to entry in Philippine enterprises and considers the linkages between the macroeconomic and the microeconomic environment. In this regard, the engagement goes through a survey of the literature and undertakes case studies into the microeconomic aspects.

STRUCTURAL ADJUSTMENT REFORMS

The study reviews the structural adjustment reforms since the 1980s. The elements of structural programs can be grouped into the following policy areas: trade and industrial policy; agricultural policy; foreign exchange management; financial market liberalization; wage and price policy; fiscal and monetary policy; privatization; and investment policy. Most of the reforms have been implemented during the Aquino administration. Many are aimed at freeing the market, increasing competitiveness, and levelling the playing field so that participants can compete on equal footing.

Still several issues have remained unresolved or inadequately addressed by the government. But substantial progress has already been made. Progress in this sense has not meant necessarily an economic turnaround but progress in promoting reform laws.

PHILIPPINE MARKET STRUCTURES

An important observation regarding Philippine industry, one that has been repeatedly documented by studies since the 1960s and the 1970s, is the high degree of industrial concentration. A few firms account for the bulk of industry sales, employment, or assets, even for broadly defined sectors.

While it can hardly be disputed that the organized private sector is highly concentrated in a few firms, it is more important from a policy viewpoint to determine whether this has normative significance or is an occasion for policy intervention. The answer, however, depends closely on the explanation given for the high concentration.

Several explanations may be advanced. First is the possibility that concentration results from the size of the domestic market relative to the minimum efficient scale of technology employed in some industries. Economies of scale themselves imply that the efficient industry is necessarily a concentrated one.

Second, concentration may have resulted from deliberate government policy of protecting and promoting some industries. Here three categories may be mentioned:

- The most straightforward is the case of the traditional natural monopolies, e.g. telecommunications, power distribution, interisland shipping, in which the government explicitly grants monopoly status at the outset. Banking also falls under this category.

- An intermediate case is that of favored industries which are the subject of explicit promotion programs. The "progressive manufacturing programs" for cars, trucks, and motorcycles, and the government's program for an integrated steel mill and for synthetic fiber manufacturing are examples.

- A third and similar case is that of "troubled" or "distressed" industries, for which the government has designed special "rehabilitation" or "modernization" programs. Textiles and cement are examples.

Finally, concentration may be the outcome of innovation (the Schumpeterian process) which gives absolute advantages to an innovating firm in the industry. The argument is that the truly dynamic efficiencies under capitalism are to be realized not through competition but through the achievement of the economies of scale. This argument is advanced, for example, in support of promoting big firms and conglomerates, as found in Japan and South Korea. Judging by the situation in the more-developed countries, size is often associated with the achievement of efficiencies, whether due to economies of scale or scope or to management efficiencies, or to investment in research and development (R&D).

Offhand, it is unlikely that many industries in the domestic market will manifest such Schumpeterian characteristics. (This assessment may be disputed in the case of some large food producers.) Again the least that must be demonstrated is that the source of the existing player's advantage is some form of absolute advantage in technology, marketing, or management, and not a policy-based privilege.

It is important to determine whether the present crop of highly-concentrated industries in the Philippines represents a response to the same forces and therefore, whether their continued promotion represents a move towards dynamic efficiency. While one would agree with the liberal analysis that the concentration in Philippine industry is the outcome of a set of forces totally different from efficiency, one should not equate large size or concentration with inefficiency.

LEGAL FRAMEWORK, POLICIES, AND PROGRAMS

The legal system itself can be an entry barrier. Various laws, policies and programs, including several provisions of the 1987 Constitution, appear to hinder entry. While some are patently restrictive, most laws might not have intended to produce anticompetitive results. For instance, various government rationalization programs explicitly limit the number of participants. Franchises or licenses *a priori* exclude other players. On the other hand, laws which might have unwittingly serve as entry barriers include investment incentive acts that end up as capacity licensing or market reservation tools, and price control statutes that act as *de facto* limit prices. Laws on insolvency, and labor can likewise deter the exit of firms and thereby act as entry barriers. Moreover, local government units in principle can block enterprise activity in their locality. Lastly, the courts can block entry or confer undue advantages, given the propensity of players to use the principle of judicial review to force or reverse certain executive or legislative actions.

It must be stressed, however, that the country is committed to free enterprise, antitrust and fair trading. The country has many statutes that prohibit unfair practices, collusion, and related barriers to entry, in accordance with the policy of the state to promote competition and prevent monopolies. However, three observations can be made as to why these statutes are virtually ineffective.

- Antitrust statutes and related legal provisions have not been compiled and collated into a comprehensive antitrust law. Furthermore, the acts that are prohibited and considered illegal are stated in terms that are not very specific.

- There is lack of jurisprudence. The Sherman Act of the United States considers price-fixing, market division, and boycott agreements among competitors as "per se" violations. They are easier to detect, prosecute, and prevent than monopolization, which is subject to the "rule of reason". Under the "per se" approach, U.S. courts have found certain practices as being inherently anticompetitive and, for this reason, condemned as illegal restraints on trade, without any analysis of their specific effects on competition. Under the "rule of reason" approach, on the other hand, particular practices are analyzed in detail and are deemed illegal only if they are shown, in specific cases, to produce anticompetitive effects that outweigh any competitive benefits. Very few cases involving monopolies and unfair competition have been adjudicated by the Philippine courts. Despite the presence of legislation, the cases were typically settled amicably in the lower courts, or the aggrieved parties were not too interested in pursuing the cases. To date, only two cases involving possible violations of Article 186 of the Revised Penal Code, have been decided by the Supreme Court. Because of this, Philippine courts have not been able to evolve either a "per se" rule or a "rule of reason" as the case may be, on activities and practices involving monopolies and unfair competition.

- While implementing rules and regulations of the different antitrust and unfair competition laws fall under various categories, several government agencies are mandated to implement related laws. Precisely because of this diffused responsibility, implementation of antitrust and related laws has not been effective.

INSTITUTIONAL AND ADMINISTRATIVE ARRANGEMENTS: FOCUS ON THE BOARD OF INVESTMENTS

The government intervenes in specific markets in response to certain private interests or normative objectives (e.g. to promote competition and to regulate monopolies). Among these are the Securities and Exchange Commission (SEC), the Central Bank (CB), the Board of Investments (BOI), the Housing and Urban Land Use Regulatory Board (HULRB), the National Telecommunications Commission (NTC), the Civil Aeronautics Board (CAB), the Land Transportation Franchising and Regulatory Board (LTFRB), the Maritime Industry Authority (MARINA), the Philippine Ports Authority (PPA), the Insurance Commission, the Sugar Regulatory Administration (SRA), the Philippine Coconut Authority (PCA), the Garments and Textile Exports Board (GTEB), and the Energy Regulatory Board (ERB).

Regulatory concerns generally bear on entry, price or rate fixing, quota allocation, market information, and externalities. Given specific regulatory settings, it is highly probable that regulators by virtue of their mandates or charters would restrict entry.. CB restriction on the grant of commercial bank licenses or NTC control of telecommunications licenses can be regarded as within the scope of such regulatory concerns. On the other hand, several cases may be cited when the regulator departs from an efficient market outcome and becomes an entry barrier; the regulator functions: (a) as captive; (b) as monopolist; (c) as bureaucrat; and (d) as indifferent trustbuster.

Against this backdrop, the study focuses on the BOI's record in promoting or restricting entry into certain industries, given that body's central role in the country's industrial development program. It has the power to define priority areas of investment and to grant (or withhold) and administer a wide variety of incentives to enterprises that qualify under its evaluation criteria.

Each year, in accordance with RA 5186, the BOI draws up an Investments Priorities Plan (IPP) in which are listed priority areas of investment. As part of the exercise to draw up the Plan, BOI also forecasts supply and demand to determine whether measured capacity exists and whether such industries qualify for the various incentives.

In drawing up the IPP, the BOI conducts hearings and consults representatives of various industries/industry groups. The BOI has explicit instructions to consider factors such as the existing and prospective demand for specific products and commodities, the existing capacities for producing specific products and commodities, the gap between prospective demand and existing supply for specific products and commodities, as well as the need to maintain competition in industry.

Certain actuations of the BOI appear to have deterred entry or served to protect the incumbents.

- For instance, there is substantial arbitrariness in the listing or delisting of industries under the IPP. An analysis of the list of preferred economic activities during the period 1986-1991 leads to at least two observations. First, the number of preferred activities has substantially declined as of 1991. This is due to the government policy of limiting as much as possible the number of preferred economic activities. Second, several economic activities that had been dropped from the IPP list were later reinstated mainly because of the perceived need to expand capacity by encouraging existing firms to increase their plant capacity, or to invite new entrants. In some instances, however, the BOI's decision was made not to encourage entrants into the industry but to accommodate requests by incumbents wishing to enjoy the fiscal incentives. The discretion exercised by the BOI in including or dropping a particular industry from the IPP virtually dictates the state of competition in an industry.

- Also questioned is BOI's wide discretion in the award of incentives. Industries favored by the BOI are given a number of basic rights and guarantees. For foreign investors, the following incentives are given: repatriation of investments; remittance of earnings; freedom from expropriation; protection of patents and other proprietary rights; and capital gains tax exemption. Philippine nationals investing in pioneer enterprises are offered such incentives as tax allowance for investments, capital gains tax exemption, and tax exemption on sale of stock dividends.

- The BOI fiscal incentives have a significant impact on the profitability of recipient firms. Investment incentives can increase the rate of return by at least 12 percentage points for pioneer firms and by 10 percentage points for non-pioneer firms. This is a substantial advantage for the firms to which the incentives are granted. Conceptually, therefore, the exclusion of an industry from the IPP confers absolute advantages on the incumbents equal to the discounted present value of the incentives given. In addition, the resulting barrier to entry can lead to monopolistic pricing by the incumbent. This is an advantage distinct from the advantages that go with the incentives.

- Lastly, a shift has been noted over the years in the focus of the BOI's activities, diluting its effectiveness in its primary function of promoting investments. The BOI has been involved in "extraneous" activities like allocating credit and foreign exchange and promoting the so-called "major industrial projects" of the Marcos administration. In the process, BOI has assumed more and more the role of a regulatory agency, a role not part of its original mission.

It is observed that the Omnibus Investments Code of 1987 provides that measured capacity "shall not result in a monopoly in any preferred area of investment which would unduly restrict trade and fair competition, nor shall it be used to deny the entry of one enterprise in any field of endeavor or activity." Despite these safeguards, the application of the test of measured capacity has served to bar entry and has thus contributed to monopolies or oligopolies in certain industries. It is, of course, possible that this may have been an unintended result of applying the concept of measured capacity.

The Foreign Investments Act of (FIA) of 1991 does not mention measured capacity. This development can be viewed as a considerable relaxation of the requirements for entry into industry and a big step towards a more competitive policy environment in the country. Nevertheless, the criteria for inclusion in List C include factors related to notions of sufficient capacity and sufficient competition.

SOCIO-POLITICAL FACTORS AFFECTING REFORMS

The explicit consideration of market power raises questions on several levels regarding the process of reform. In general, economic policies cannot be conceived of as arising in a vacuum but are the outcome of the actions of defined social groups pursuing their interests. Policy therefore is not "designed" but is the outcome of a social process of conflict and bargaining. It is considered necessary that the State, if it is to be "developmental," must at once be able to stimulate and discipline the elite and rechannel, if not minimize, rent-seeking activities.

The presence of small groups exercising market power strengthens the bias for lobbying in their favor. The benefits to these groups of a continued restraint on competition are more focused and the costs of organizing are less than for many of the penalized users, e.g., consumers for whom benefits from competition are diffuse. The strength of this lobby has been tested in the related move of trade liberalization.

The social influence of interests in concentrated industries becomes more formidable when it is considered that, very often, these are merely part of larger "groups" or conglomerates. The influence of large conglomerates may be exercised not only through markets but, more importantly, through the political system itself.

A second broad implication of the recognition of groups, however, is that the political economy of concentrated industries may not always run along lines of collusion. Competition in other branches of the economy or in politics may influence the state of collusion or competition between interests in a particular branch, since they may belong to different groups, or stakes larger than profits in that particular industry are involved.

Competition among large groups is not necessarily an indication of contestability, however, since it may pertain to nothing more than attempts (mainly through the political system) to effect changes in ownership of dominant enterprises without changing their economic function.

The fact that groups in some Newly Industrialized Economies (NIEs) have played an important role in economic development may be due to the fact that the State has displayed an autonomy sufficient to discipline and stimulate them, while in the Philippines the State is prone to capture by vested interests. Hence the distinction between "strong" and "weak" States.

The performance of the Aquino administration has led to a general conclusion -- at times unwarranted -- regarding the generic difficulties of reform under democratic institutions. This is illustrated by disharmony between the branches of government and within them.

The executive and legislative branches of the government differ in the degree of their susceptibility to lobbying, with the latter showing itself to be more susceptible. Second, there is not always agreement within the executive itself, projecting weakness and indecision to the outside world. Third, the pivotal role of pressure from multilateral agencies in many of the reform efforts creates a perception that reforms are imposed from without, leading to an isolation of the executive as an instrument of external interests.

The malaise affecting decision making under the Aquino administration has been the visible loss of the ability to adhere to a coherent and final executive agenda. In turn, the lack of consistency and finality in the executive's economic decisions may be traced, on the one hand, to the weak center in the executive (especially due to an indifferent instinct for economic matters) and, on the other hand, to the heterogeneous and variable character of the coalition which placed the current administration in power. This has resulted in substantial lobbying within the executive branch itself and a perceived dilution of the commitment to reforms. Finally, litigiousness has also been a distinct source of difficulty for potential entrants and has provided an opening for particularist interests to affect major national projects or the entry of new market participants.

The conflicts described give rise to a general impression of a policy drift in the Aquino government. The succeeding executive will have to accept these forces as givens under a constitutional democracy and still manage to build coalitions skillfully enough to implement a program of reforms.

ENTRY BARRIERS IN PHILIPPINE INDUSTRIES

Entry barriers may be (a) policy-induced or (b) structural. Various studies indicate entry barriers in Philippine industries are generally induced by policy.

Policy-induced barriers encountered in the engagement are:

Direct restriction of entrants. The most obvious restriction of entry occurs in those instances where the government explicitly limits the number of participants in the industry as a matter of policy. One variant of this is the usual practice of franchising or licensing utilities, as may be found in shipping, telephone services, energy generation and distribution, and banking. In other contexts, such as the car and cement industries, rationalization programs provide another occasion for restricting entry.

Fiscal incentives. When conferred selectively, fiscal incentives can serve as entry barriers by giving absolute cost advantages to the firms that obtain them. These are administered chiefly by the BOI. A recent study shows that the internal rates of return of firms that manage to avail of the incentives can be as high as 12 percentage points more than what can be achieved without the incentives.

Credit subsidies. The selective provision of subsidized credit also serves as an entry barrier when the same terms are not made available to all potential entrants at all times. For example, lending by government institutions may implicitly keep track of capacity, so that subsidized lending to additional entrants stops when the industry is perceived as "full." Another important effect of government financial involvement in the industry has been to render it prone to responding to demands of industries for regulation and restoring "orderly conditions" in the industry.

Bureaucratic requirements. Even if there is no policy restricting entry, extensive bureaucratic requirements can significantly raise the cost of opening or expanding. This applies particularly to small- and medium-sized firms with limited resources relative to transaction costs incurred in dealing with bureaucratic requirements.

Import restrictions and tariffs by themselves are not entry barriers, since they may well exist in both contestable and noncontestable markets. However, import protection may serve to reinforce a prior existing dominant or monopolistic position and may sustain an incumbent despite its inefficiency. Documented instances of this occurrence are to be found in the steel industry, automobiles, flour milling, pulp and paper, home appliances, and many other industries. Import protection often also serves as an impediment to structural change. Industries that have been protected for long periods of time have benefitted from the protections and are likely to resist any effort to remove such benefits from them.

Price or rate regulation in certain instances also served to set price limits and discourage entry and maintain the existing configuration of firms in an industry. This is especially relevant in cases where the existing firms in the industry find it difficult to police themselves and accordingly create a demand for regulation.

Exit barriers. Barriers to exit may well be entry barriers if they make it difficult for investors to shift resources from one economic activity to another, as the shift would involve closing down firms, so that potential investors become more cautious in entering markets. Whether labor and bankruptcy laws in effect pose an exit barrier cannot be conclusively shown.

A general rationale for the government's policy of selective promotion or protection is that they prevent overinvestment in certain industries. This policy is justifiable only to the extent that the promoted industries make use of some scarce resource whose social opportunity cost is actually greater. Most of the time, this scarce resource is foreign exchange, but it may well be capital as well or scarce government revenues. Where rationing is not necessary such as where foreign exchange and credit are competitively priced, the restriction of entry itself becomes superfluous.

Structural barriers to entry are:

Scale economies and excess capacity. Two instances of excess capacity may be distinguished: in the case of hitherto distressed industries such as cement, the existence of excess capacity is the result of previous overinvestment owing to government encouragement; on the other hand, even profitable firms may choose to hold excess capacity as an aggressive strategy (e.g., glass).

Absolute advantages. These refer to those advantages arising from the peculiar nature of the technology or marketing enjoyed by incumbents. Examples of these are to be found in telephone services where there is monopoly in the domestic backbone service, and in flat glass, where the incumbent has a ready market.

High capital requirements and imperfect capital markets. These are important structural barriers to entry in the Philippines. Financial markets are highly segmented and access to their facilities is quite difficult. Those without access to capital are effectively shut off; this means competition is effectively limited to larger firms and conglomerates.

Predatory or limit pricing. This refers to pricing low to deter new entrants or drive out competitors. In some cases studied, domestic producers entered trading when imports were liberalized to price out competing independent traders.

Product differentiation and brand loyalty. This has not been documented systematically in the engagement. We note, however, that the dominant incumbent firms in telephone services and steel are heavy spenders in advertising. Likewise, players in car assembly, banking, appliance manufacturing, tire making, and, to a lesser extent, cement manufacturing advertise regularly to distinguish their products from those of their rivals and create brand loyalty. On the other hand, incumbents in polyester fiber and flat glass appear to have relatively little need for advertising.

Incumbent reactions. These can deter entry when the incumbents make life extremely difficult for new players. The use of the regulatory process or judicial system is usually resorted by incumbents in blocking competition. Regulators in these particular instances have to ease entry rules or make them highly transparent.

ASSESSMENT OF EFFECTS

In the majority of the cases, there are strong indications of negative effects of entry barriers on users. In many instances, domestic user-prices higher than border prices were clearly observed. Where the highly protected domestic producer sells in both the domestic and export market, domestic prices are typically higher than export prices.

Barriers to entry serve to keep inefficient firms operating or, if these firms are efficient, allow them to generate monopoly rents. The absence or restriction of new entrants served to make incumbents complacent, content with low profits, and unwilling to innovate or put in new investments.

The existing advantages enjoyed by dominant firms may in certain situations even render policy changes like trade liberalization ineffective. Where the dominant producer is itself a trader, it may practice predatory pricing against independent traders, selling imports (but not domestically produced output) at a cost which does not allow a fair profit. One would then observe a gradual reduction in the number of independent traders as well as the amount of imports.

To the extent that monopoly rents are to be made owing to entry barriers in the domestic market, both incumbents and potential entrants are induced to continue focusing on the capture of those rents, rather than producing for a competitive external market. The fact that large capital requirements are an important entry barrier means that for both incumbents and entrants, the threat of entry is a game for high stakes (especially where capital markets are imperfect) and will attract many of the important business groups.

Government continues to play a large role in determining whether entry is warranted and the conditions under which it occurs. The capacity to provide fiscal incentives and trade protection (in earlier periods also subsidized credit) vest the authorities with substantial power in determining when entry is permissible.

Government restricts entry and provides other incentives until it deems domestic and, to a lesser extent, foreign demand have expanded sufficiently to warrant a further expansion of capacity, whether this be by incumbents or potential entrants. In effect, it has internalized a good deal of the risks associated with setting up in those selected areas. Much of the estimated costs associated with the system of investment promotion in this country pertain to the revenues foregone. An additional social cost is that imposed by the restriction of entry and the industrial configuration it creates.

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In the main, the conclusion must be that policy-induced barriers to entry have proved more significant than structurally determined ones. Indeed in many cases, the presence of policy intervention has formed the basis for structural barriers to entry such as excess capacity, absolute advantages (through franchises, credit subsidies and fiscal incentives), and limit pricing (via price and rate regulation). The Study Team also believes the most important barriers are fiscal incentives and capital market imperfections. Hence, the first line of attack to reduce or lower barriers must be in these areas.

AGENDA FOR GREATER COMPETITION

Given the foregoing, the Study Team proposes an agenda for policy, research and technical assistance that will foster greater competition in Philippine industries.

Outlines of a Competition Policy

Accordingly, the SGV Study Team has outlined certain elements of a competition policy. On one hand, the proposed reforms of the incentives, capacity licensing, public utility, and exit policies seek to remove or lower barriers. On the other hand, the proposed antitrust policy bears on the behavioral dimension. This is reinforced by institutional reforms, namely the establishment of a central antitrust authority and, relatedly, the overhaul of the bureaucracy.

Reforms of general scope

The Philippines has already introduced substantial policy reforms designed to improve the performance of the economy. These need to be sustained, and any attempt to reverse the policy must be resisted. That many of these reforms have been supported by a certain legal framework (e.g. FIA of 1991, Executive Order 470, etc.) indeed gives some kind of an assurance that they are here to stay at least in the medium term. Reform efforts should now be directed at the microeconomic level; the following reforms are proposed:

- *Incentives policy.* Fiscal incentives and special credit programs have been used to promote certain industries. These have conferred undue advantages to incumbents or to the first few entrants and have limited competition, not to mention their budgetary implications because of the foregone tax revenues and credit subsidies.

  The focus of the policy should be shifted from promoting certain industries to enhancing competition; it means eventual withdrawal of those incentives, first by making existing ones time bound, gradually reducing these over time, and not granting new ones. The current trend of using credit programs to promote competition and efficient firms should be continued.

- *Capacity licensing and markets.* Most important is a reorientation of industrial policy to shift it away from preoccupation with meeting domestic demand to that of achieving international competitiveness. This reorientation will, by the same stroke, address the other objectives capacity licensing has sought to achieve in the past, such as achieving scale economies and ensuring good product quality, not to mention increased employment. If international competitiveness is attained, then it will not matter where firms sell their products. Under this policy, the content of regulation and promotional programs will be different. Product quality, which has often been denied to domestic consumers, will be given more attention. Programs involving the gathering and dissemination of market information could be promoted.

- *Public utility policy.* Up to now the policy on public utilities has been to regulate to prevent monopoly rents and deadweight losses. Recent positive experience suggests the need for greater competition. Regulators should liberalizo markets and allow more players. If competition within the market is not possible, then one option is to increase competition for the market.

- *Exit policy.* Freer exit could reduce entry barriers and encourage more competition. Firms should have a clear signal from the government regarding the policy on exit. More specifically, the government should have a strong policy against intervention in nonviable firms, regardless of whether the government, through its financial institutions, has some exposure or not. Rationalization programs, which in the past resulted in an oligopolistic or monopolistic market structure, should be avoided. Inefficient firms should be allowed to fold up.

Adoption of a clearly-defined antitrust policy

There is a great need for antitrust legislation and policy that is clearly defined and suited to the attainment of international competitiveness. An integrated approach is therefore necessary with respect to all government policies directly or indirectly affecting competition in general and acquisition of control in particular. This includes policies on foreign trade, foreign investments, industry and structural adjustment, deregulation, privatization, consumer protection, financial market, and firm structures.

There is a very strong need for consistency and coherence between such policies and any competition and antitrust law which may be enacted by the state. This need is particularly important in trade policy, where the benefits of international trade liberalization may be reduced by the anti competitive conduct of dominant firms; in industrial policy, which can promote either large firms or small and medium enterprises; and in deregulation and privatization policies, where it would be necessary to ensure that firms do not take advantage of the withdrawal of government to engage in unfair competition. To avoid unnecessary distortion of business decisions, there is also a need to ensure consistency and a degree of neutrality in the application of competition laws towards different types of restrictive business practices, existing monopolies, mergers, joint ventures, and interlocking shareholdings and directorates, taking into account differences in their effects.

While merger/acquisition/consolidation is accommodated by the law, some measures should be taken so that the emerging firm does not acquire substantial market power to deter entry or keep prices above competitive levels. The antitrust law should be clear on this point. In the telecommunications industry, for example, the currently dominant firm which already controls more than 90 percent of the market, should not be allowed to buy out other smaller participants or new entrants.

The proposed antitrust law should specify its objectives and the practices or arrangements among enterprises that should be prohibited outright or in principle. It should be guided by the concept of contestability (that is, allowing monopolies to exist but keeping open the threat of entry so that they are forced to act as perfect competitors). In addition, it should provide for enforcement by the administering or controlling authority. This should include the procedure to be followed by enterprises in notifying or reporting their activities, contracts, proposals to the authority, as required by the latter. The powers of the authority, as well as the sanctions to be imposed on violations, should be well-defined.

Institutional reforms

Proposed institutional reforms include:

- *Establishment of a central antitrust authority.* The effective implementation and enforcement of the Philippine antitrust law has been rendered difficult by the absence of a centralized agency, vested with sufficient powers. A strong, central antitrust agency must be formed with the duty to oversee the competitive climate in different sectors of the economy within the context of a comprehensive antitrust policy embodied in appropriate legislation. Its functions shall combine among others those of the SEC and the Bureau of Patents, Trademarks and Technology Transfer (Patents Bureau).

  There are several alternative institutional arrangements: (a) creation of a new entity; (b) creation of a task force or coordinating committee; and (c) transformation of BOI into a body that will implement the country's competition policy, including enforcement of antitrust laws. We tend towards the third alternative. Investments promotions or, more broadly, industrial development, can be enhanced by promotion of competition,i.e. through removing or lowering barriers or minimizing their negative effects. Further, enforcement of antitrust laws could be put within the context of a competition policy.

- *Overhaul of the bureaucracy.* There is need to overhaul the bureaucracy. In general terms this means in-depth reassessment of the rationale for regulation and review of the roles of regulatory bodies. The objective is streamlining and simplifying bureaucratic requirements as well as eliminating excess layers.

Industry-specific reforms

In support of the competition policy outlined above, the Study Team proposes certain industry-specific reforms drawn on the case studies on telecommunications (telephone services), manufacture of man-made fibers, glass manufacturing, cement manufacturing, iron and steel making, and manufacture and assembly of motor cars.

Generally, the reforms are aimed at opening the sectors to greater competition or at least to turn monopolies into contestable ones.

- In telecommunications, technological advances have brought about the need to open certain segments to greater competition (see discussion above on public utility policy and Demsetz competition). Institution-building is therefore top priority so that regulator is technically capable to handle emerging complex issues. Pricing policies have to be reformed to allow significant pricing flexibility in market segments which face greater competition.

- In the manufacture of man-made fibers, we propose to transform the polyester fiber monopoly into a contestable monopoly. Three measures could be adopted in this regard -- liberalization of imports and continued tariff, substantial reduction or withdrawal of fiscal incentives and removal of manmade fiber altogether from the IPP list, and encouragement of foreign investments.

- For the glass manufacturing, we propose a review of the tariff structure on flat glass. We believe that the incumbent firm does not need protection, having shown in the past that it can compete in the export markets and that it can handle threats of imports in its domestic turf. We therefore propose to open the sector to international competition.

- Cement manufacturing has undergone deregulation and liberalization since 1986. This policy trend should be sustained. Consequently, government should no longer tolerate the informal (read collusionary) marketing arrangements within the sector. Relaxation of import restrictions must be sustained. Foreign ownership of cement plants should be liberalized. Lastly, industry should be encouraged to turn increasingly to the export markets to achieve the scale economies needed.

- Completion of an integrated steel mill appears to be a legitimate policy goal. There are now two contending parties, the National Steel Corporation (NSC) and the Jacinto group allied with Chinese interests. Given this backdrop, we propose two complementary measures. One is to immediately initiate the privatization of NSC; this implies resolution of the legal impediments. The other is to delist the industry from the 1992 list so that new entrants could come in without expecting government incentives and protection. The objective is to put the privatized NSC and new entrants on equal competitive footing. Any first-mover advantages of NSC could be offset by new entrants through technology, organization, market diversification, choice of location, marketing tie-ups with foreign firms, etc.

- With regards to manufacture and assembly of motor cars, there is need to recognize the failure of the Car Development Program (CDP). The latest proposal to open a "luxury car" category is mere tinkering. We propose to open the domestic market to competition. This should be underscored by phaseout of incentives within two years and the free imports of cars. Incentives could continue for R&D activities. This should encourage innovation and lead to higher production efficiency. Uncompetitive players will simply wither away while the more efficient ones will remain without significant loss of government revenues.

Recommendations for private group activities

Private sector activities in support of the competition policy include constituency-building, information dissemination, and implementation of safety nets. Donor support could be directed towards these activities. One agency which could be tapped for policy advocacy is the Private Investment and Trade Opportunities-Philippines (PITO-P)

Recommendation for public investment programming

The reforms proposed above will have certain implications on public investment programming. For instance, healthier budgetary allocations should be channeled to infrastructure and energy if the goal of achieving competitiveness for many industries is to be achieved. On the other hand, the phased withdrawal of incentives should improve the government revenue sufficiently to undertake some of these improvements. Giving private sector greater access to Official Development Assistance (ODA) funds to finance long-gestation projects under the Build-Operate-Transfer (BOT) schemes is a step in the right direction. There is a need to institutionalize this in the public investment programming process.

Sequencing, Timing and Form of Reforms

By mid-1992, the country will have a new leadership. We propose that the new leadership adopts the proposed recommendations as part of its economic agenda.

We propose that efforts at macroeconomic stabilization reforms be sustained and structural adjustment reforms be continued. Within a more favorable macroeconomic environment, policy, legal, and regulatory and administrative reforms should be launched simultaneously.

- Reforms of the incentives, capacity licensing, public utility and exit policies must be undertaken jointly. Incentive reforms, in particular, should go hand in hand with the liberalization of the financial markets and financial sector reforms (improvement of CB net position) as financial repression might just negate any changes in incentives policy.

- Reform of the capacity licensing system should be phased with changes in the drawing up of the IPP. We also note the need for export promotion measures to encourage domestic producers to turn to the export markets.

- The implications of both the reforms of the incentives and capacity licensing systems on the BOI should be assessed, given the likely diminution of BOI's current activities. On the other hand, institutional arrangements to promote the competition policy might lead to an expansion of BOI's role.

- Changes in the exit policy should be finetuned with policy changes on entry barriers. This might require a thorough reassessment of related laws within the context of formulating the competition and antitrust policy.

- Reforms in the public utility policy will have to go in hand with the overhaul of the bureaucracy, particularly in the review of the regulatory systems. Streamlining of bureaucratic procedures and systems could trigger this overhaul of the bureaucracy. Institution-building, including the formulation of antitrust policy and the design of institutional arrangement, should be started.

- The establishment of the institution to implement competition policy should complete the first phase of the microeconomic reforms.

The new leadership should announce its economic agenda within the very first five days of its administration. The timetable should be compressed within a 12-month period. Along the general lines proposed above, whatever could be accomplished through administrative means should be done immediately. These include: preparation of the negative lists; preparation of the priorities plan; deregulation in banking and foreign exchange markets and in the transport sector; and simplification of bureaucratic procedures.

Certain aspects of the competition policy will need the act of Congress. It is important for the new leadership to indicate its preferred policy direction and draft the required bills as soon as possible. Lastly, the new leadership must seek to build consensus for the proposed reforms.

Research Issues

The Study Team has pinpointed certain research issues. Priority research issues include: (a) determination and assessment of strategic industries and (b) study in relation to formulation of an antitrust policy which would include broader industry coverage, investigation through model estimation, and better quantification of welfare effects.

Other research areas include: sharper tests for contestability; role of LGU in enterprise activity regulation or deregulation; closer study of certain laws that might represent exit barriers; qualitative analysis of ownership structures within and across industries; mapping of the dynamics of competition in particular industries and its relation to the activities of cross-industry conglomerates or power blocs.

There are also research issues arising from the case studies.

- *Telecommunications (telephone services)* -- a case study of the failed privatization of the government telephone systems; in-depth study of the effects of barriers to cover the telecommunications industry as a whole; a study to determine market segments which should be opened up to greater competition.

- *Manufacture of man-made fibers* -- an update of the Mercado (1987) study (see literature survey in Part I of Volume II); a study of barriers to cover downstream industries (garments).

- *Glass manufacturing* -- an empirical study of import misdeclaration under the import liberalization program and the ASEAN margin of preferences; a study of trade policies of countries with potential markets for flat glass.

- *Cement manufacturing* -- measurement of the consumer welfare loss due to rents related to entry barriers; study of the dynamics of family group competition (Phinma, Zobel-Araneta, Alcantara, E. Cojuangco, etc.).

- *Iron and steel making* -- an impact assessment of import liberalization on NSC; review of country experiences on the establishment of a fully integrated steel mill.

- *Manufacture and assembly of motor cars* -- an assessment of the fiscal and employment implications of proposed phaseout of incentives and free imports of cars; a study of successful country experiences in setting up a domestic car industry may also be included in the research agenda.

Technical Assistance

Technical assistance may be called for in four areas: (a) support for the studies suggested above, with emphasis on those needed in framing the proposed antitrust law; (b) support for institutional development in creating a central authority to implement and enforce the proposed antitrust law and promote competition and support for the initial phases of the setting up of the antitrust institution and training of people; (c) support in relation to the overhaul of the bureaucracy; and (d) support for private sector activities relevant to the implementation of the competition policy.

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
BARRIERS TO ENTRY STUDY
FINAL REPORT

I INTRODUCTION

BACKGROUND

The United States Agency for International Development (USAID) Philippines has commissioned SGV Consulting (SGV) to undertake an exploratory study on barriers to entry in the Philippines.

The engagement aims:

- to develop background information on entry barriers in the country, and
- to the extent that certain types are undesirable or inappropriate, propose policy recommendations that will help remove these or minimize their negative effects.

Despite structural adjustment efforts since the early 1980s, the economy remains vulnerable to shocks, and growth appears fragile. One reason is that structural reforms designed to enhance competitiveness are impeded by barriers in the microeconomic level.

In general terms, discussions on entry barriers postulate that various elements of the industry structure can impose disadvantages on entrants (new competitors) which are not borne by incumbents (existing players). Bain (1956) cites three sources of this advantage to incumbency: (a) scale economies, (b) product differentiation, and (c) absolute cost advantages. Porter (1979) expands the sources of entry barriers to six: (a) cost advantages independent of size, (b) capital requirements, (c) product differentiation, (d) access to distribution channels, (e) economies of scale, and (f) government policy.

Barriers can be viewed in a dynamic sense as a reality in competitive markets. Enterprises seek to sustain their competitive advantage through product development, brand differentiation, market diversification, creation of distribution networks, or similar moves that would deter the entry of other rivals. Potential new entrants, on the other hand, strive to break down these barriers through their own innovative strategies.

The interplay of competitive forces reflected in this constant erection or dismantling of barriers results eventually in efficient resource allocation and use of resources and ultimately in enhanced consumer welfare.

Often, however, barriers reflect noncompetitive or anticompetitive situations. These occur when barriers are erected because of inappropriate government intervention or rent-seeking activities of certain groups. These types of barriers persist in the Philippines and tend to limit the effectiveness of adjustment efforts. Reforms at the microeconomic/ industry level are necessary to complement as well as sustain the economic structural changes. Conversely, macroeconomic stability enhances the effectiveness of microeconomic reforms.

In this regard, the Barriers to Entry study is opportune as it indicates policy issues that will hopefully lead to greater in-depth analysis and adoption of needed microeconomic reforms.

SCOPE OF WORK

The Barriers to Entry Study delves into the following interrelated areas:

- *Review of theoretical considerations and survey of literature.* This covers the theoretical issues and findings of the literature survey. It provides the conceptual framework for the study and establishes the link between the ongoing structural adjustment reforms and industrial organization.

- *Assessment of adjustment reforms and market structures.* This assesses the progress of structural adjustment reforms vis-a-vis objectives. Further, this leads to an analysis of the Philippine industry and market structure.

- *Evaluation of legal framework, policies, and programs.* This focuses on laws, policies and programs, with broad implications on the economy and industrial organization, and demonstrates how these unwittingly or wittingly serve as entry barriers.

- *Assessment of institutional and administrative arrangements.* Assessment focuses on a specific regulatory agency, the Board of Investments (BOI). In the sectoral case studies, policy review is industry-specific, focusing on licenses, franchises, and grants of special privileges that lead to monopolistic or oligopolistic structures.

- *Review of political economy issues.* Social and political factors hindering reforms are identified in the discussion of the political economy of reform.

The study then proceeds to:

- *Identification of policy-induced and structural entry barriers and assessment of their effects.* Six industry sectors have been selected for case studies to illustrate specific examples of policy-induced and structural (taken to mean also natural or strategic) entry barriers and of oligopolistic/ monopolistic behavior. The sectoral case study contains an analysis of the industry structure to determine the nature and degree of competition and the impact of barriers on end-users, the dominant firm and competition, and government objectives. The findings serve as basis for an overall assessment of effects.

The goal is:

- *Formulation of a policy and research agenda toward greater competition.* Reforms to remove or lower barriers and deter anticompetitive behavior are proposed. This is to foster competition and enhance competitiveness at microeconomic level and to support or complement structural reforms ongoing since 1980.

ORGANIZATION OF THE REPORT

The Report is presented in two volumes.

Volume I contains the Main Report. It discusses the theoretical issues related to the central themes of the study and presents the assessment of adjustment reforms and market structures, legal and policy framework, administrative arrangements, and political economy issues. Based on the case studies and literature survey, it identifies barriers to entry in industries and assesses their effects. Finally, it proposes an agenda for greater competition.

Volume II has two parts. Part I provides a survey of Philippine literature. Part II contains case studies on entry barriers in telecommunications (telephone services), manufacture of manmade fibers (polyester fiber), glass manufacturing, cement manufacturing, iron and steel making, and manufacture and assembly of motor cars.

The SGV Study Team anticipates that the Report will have differing levels of readership. Some readers may want to go through a discussion of the theory of entry barriers and of Philippine market structures which are presented in Chapters II and III. Others who may wish to focus on legal and regulatory issues can concentrate on Chapters IV and V. Socio-political factors covered in Chapter VI may interest the political economists. Readers who may want to focus on study findings and policy recommendations can go direct to Chapters VII and VIII.

SURVEY OF PHILIPPINE LITERATURE: STYLIZED FACTS

Based on the literature survey, the field of industrial organization in the Philippines is relatively undeveloped. Theoretical and empirical works on industrial organization in the tradition of the structure - conduct - performance paradigm (SCPP) are limited.

The survey reveals only five cross-section studies that deal with the central themes of the engagement. These invariably focus on the degree of industry concentration and of protection with the end in view of assessing the state of competition in the entire sector. In addition, several subsector studies provide certain indications of industrial organization structure, conduct, and performance, although these themes are not their main concerns. Political economy literature seems to be more prolific in providing analyses of Philippine industry structures.

Despite the relative scantiness of Philippine literature, a set of stylized facts related to entry barriers and other themes of the study can be derived from our survey. Among these facts are:

- Given high concentration ratios, the manufacturing sector can be characterized as monopolistic (Lindsey 1977). Capital intensity and the degree of fabrication act as barriers to entry (Lindsey 1977). The degree of capital intensity, minimum efficient scale, and working capital requirements act as barriers to entry and lead to concentration (E.S. de Dios 1986).

- High levels of concentration lead to monopoly power (Lindsey 1977). Establishment concentration permits the earning of monopolistic profits (E.S. de Dios 1986). High profits attract new entrants and eventually diminishes concentration (Lindsey 1978).

- Tariff protection leads to concentration (E.S. de Dios 1986). Nontariff measures also result in concentration (L.C. de Dios 1987). High protection due to tariffs and import restrictions gives rise to inefficiencies (see subsector studies).

- Oligopolistic structures reduce consumer welfare and mask inefficiencies of industry players (see subsector studies).

- Rent-seeking lead to the rise of oligopolistic/monopolistic structures (see Haggard 1990; E.S. de Dios 1988). This appears evident in both the Marcos and Aquino presidencies as well as in previous regimes (Kunio 1988; Doherty 1980).

- Rents arise from: (a) special privileges granted by the government through the powers of licensing and regulation, (b) a dominant position in the market usually because of artificial barriers to entry, (c) ownership rights, (d) special access to resources, and (e) system of protection accorded by high tariff rates or quantitative restrictions (Chikiamco 1992).

- The oligopolistic structures, and thereby entry barriers, have persisted. Reforms such as tariff reduction and import liberalization can increase competitiveness and lead to efficiency (Tan 1989; Mercado 1988; World Bank 1991).

- Vested interests often block efforts to introduce reforms required to increase competitiveness (Lim 1991). The reentry of established social forces in government raises barriers as well (E.S. de Dios 1988; Haggard 1990). Policymakers must seek for a counterweight to these groups or put together a coalition to push reforms.

APPROACH AND METHODOLOGY

Approaches

The approaches taken by the study are both (a) positive and (b) normative. The positive approach seeks to investigate market and industry structures in the Philippines, determine existence of entry barriers, and identify whether these are policy-induced or related to industry organizations.

The normative approach assesses the effects of these barriers on users, the dominant firm(s), competition, and government development objectives, and considers impact on overall competitiveness and efficiency. In line with this, it also proposes reforms that will help remove or lower entry barriers.

The study takes both a micro and macro view of barriers to entry in Philippine enterprises and considers the linkages between macroeconomic and microeconomic environment. To reiterate, the interaction between macroeconomic and microeconomic reforms suggests that each sets the limits to the success of the other.

The review of Philippine literature indicates the presence of high levels of concentration, an observation further validated by the analysis on the Philippine market and industry structures presented in Chapter III. To probe deeper into microeconomic issues, the study team goes through a survey of literature and undertakes case studies of selected industries.

Methodology

This engagement comes at a time when the field of industrial organization itself is undergoing a period of reexamination. As a result the methodology that the SGV Study Team used could not remain oblivious to the changing thinking in the industrial organization literature itself. As indicated in the review of Philippine literature, the standard methodology in investigating entry barriers had tended towards large cross-section studies, typically of the manufacturing sector, with the end in view of making summary statements regarding the state of competition in the entire sector.

It is the Study Team's view that most if not all of the "stylized facts" which might be derived have already been revealed by previous studies (the main results of which have been summarized above). Hence the cue is taken from Schmalensee (1989) who concludes in a recent critical survey of such interindustry studies of structure and performance that

> "...cross-section studies are limited by serious problems of interpretation and measurement. Future interindustry research should opt for a modest, descriptive orientation and aim to complement case studies by uncovering robust empirical regularities that can be used to evaluate and develop theoretical tools."

A more modest approach is warranted precisely by our deepening understanding of the reasons for barriers to entry and industrial concentration. As pointed out in the review of theoretical literature below, for example, the fact of concentration itself need not impose a social cost, e.g., a market might be more or less contestable. On the other hand, above-normal profits by themselves do not necessarily present an instance for public intervention, e.g. if the returns are due to rents on an innovation. Yet it is precisely these issues to which the traditional econometric cross-section studies are least sensitive. To do justice to the complexity of the issues involved, therefore, it is seen fit to rely principally on a longitudinal and in-depth analysis of barriers to entry in particular industries.

The implicit model guiding the case studies is the following: let r(t) denote some measure of economic performance by the industry as time t, such as rate of return. r(t) will be generally held to depend on cost and demand variables typically suggested by standard theory, which we summarize in the vector $Z(t) = [z_1(t), z_2(t), ...z_m(t)]$. On the other hand, let the various hypothesized entry barriers be denoted by the vector $V(t) = [v_1(t), v_2(t),...,v_k(t)]$. For some t, some or all of the vj(t) may be zero. Then the point is to test:

$$r(t) = f[Z(t);V(t)...]$$

The presence of entry barriers is then to be discerned through significant coefficients for at least some of the components of V(t). An econometric implementation of the above would be ideal if data were available. At its simplest, a change in the policy-environment may be represented as a dummy variable.

The Study Team has found out that there is great difficulty in constructing a sufficient time series of the relevant variables for specific industries. In the case of policy-induced variables to entry, moreover, there may be no way of econometrically testing for the significance of such factors if the particular policy coincides with the start of the available time series.

In practice, therefore, the above framework must be implemented primarily by using expert information through (a) analysis of secondary data, (b) interviews with key informants, and (c) taking a historical-descriptive approach. The essence of the approach remains the same and that is to trace the impact of entry barriers on the industry's performance or profitability, basically through less formal "event-study" techniques.

Study Tasks

Given the study approaches and methodology as described above the tasks can be divided into: (a) review, (b) investigative, (c) assessment, and (d) policy design and formulation.

Review tasks

The review tasks cover the survey of literature, the overview of legal framework, the overview of government programs and policies, and review of socio-political factors. In these review tasks, the Study Team benefitted from several existing studies previously done by The World Bank, Philippine Institute for Development Studies (PIDS), and several college units of the University of the Philippines (School of Economics, College of Business Administration, and College of Public Administration).

Investigation tasks

In-depth investigation by the Study Team focuses on the Philippine market and industrial structures; the institutional-administrative arrangements; and market structures of specific sectors.

- *Analysis of Philippine markets and industrial structures.* This aims to determine levels of market concentration as measure of imperfect competition. Analysis is largely based on concentration ratios computed as the share of the aggregate value added of the top three firms and top four firms to sectoral value added and the changes that have occurred through time where comparison is feasible.

- *Assessment of institutional-administrative arrangements for the regulation of monopoly and promotion of competition.* This focuses on one regulatory body, the BOI, the agency charged to promote investments in the Philippines. In recent years, it has been said to concentrate increasingly on its regulatory functions. Investigation seeks to what extent the BOI has served as an entry barrier instead of being facilitative in entry of new players in industry.

- *Evaluation of market structures of industry sectors.* The case studies take a micro (industry-specific) view of entry barriers and oligopolistic/ monopolistic behavior. Six sectors have been selected on the basis of the following quantitative and qualitative criteria: (a) concentration ratios as defined above; (b) price comparisons; (c) structural importance gauged on the basis of the programs of the government (car manufacturing, appliance manufacturing, etc.), linkages to the economy, and contribution to value added; and (d) relevance to economic development.

  The concentration ratios serve as the primary basis to determine where oligopolies or monopolies might exist. The higher the degree of concentration, the higher the possibility that a monopolistic/ oligopolistic structure exists. This criterion is then crosschecked with the other criteria to narrow down the list of potential candidates for case studies. If a sector ranks high in the other criteria, then the consultants determine whether it is an appropriate subject for study.

On this basis, six sectors have been selected: (a) telecommunications (telephone services); (b) manufacture of manmade fibers; (c) glass manufacturing; (d) cement manufacturing; (e) iron and steel making; and (f) manufacture and assembly of motor cars (see **Table 1.1**).

Each case study examines the industry profile and structure as well as the policy and regulatory framework. The deeper issue here is not concentration per se but the identification of entry barriers and assessment of effects on overall competitiveness and efficiency. Where appropriate, the case studies also highlight instances of "before" and "after" deregulation as can be seen in telephone services and cement.

Assessment and Integration tasks

These tasks actually overlap with the investigative tasks and form an iterative process. Assessment seeks to determine: (a) the adequacy and effectiveness of existing laws and policies relevant to entry barriers and oligopolistic/ monopolistic behavior; (b) the implementation record of a regulatory body, the BOI; and (c) impact on users, dominant firm (s), actual and potential competitors, and government objectives.

Assessment findings are validated through key informant interviews and integrated to arrive at definitive conclusions on barriers to entry in the Philippines. This serves as basis for the final tasks.

Policy design and formulation

The policy formulation tasks have been specified in the Terms of Reference (TOR). These include: industry-specific recommendations, recommendations for form, timing and sequencing of reforms, and technical assistance and further research recommendations.

The policy options were presented by SGV Study Team in a policy group discussion involving representatives of the public and private sectors and the academe. On two occasions, the Study Team gave briefings on the study findings to officials from USAID and the US embassy. The group discussion and the two briefings generated comments which to a great extent proved beneficial to the Study Team in finalizing their Report.

Table 1.1
Industries Selected for Case Studies

	PSIC Code	Industry Description	Concentration Ratio Top 3 firms	Concentration Ratio Top 4 firms	Price Comparison (1988)[1]	Gross Value Added, 1988 Amount (₱ million)	Gross Value Added, 1988 % to Total Sector[2]	Structural Importance: Announced Policy of the Gov't	Structural Importance: Linkages of the Industry	Structural Importance: Relevance to Economic Development
1.	7320	Telecommunication (Telephone services)	99.12	99.27	N/A	6,150	24.00	Yes	Services	High
2.	3513	Manufacture of Synthetic Resins, Plastic Materials and Man-made Fibers, except glass	76.00	84.86	N/A	1,188	0.96	N/A	Manufacturing/Intermediate	High
3.	3620	Manufacture of Glass and Glass Products	83.51	89.11	5.93	1,681	1.36	N/A	Manufacturing/Intermediate	Medium
4.	3630	Manufacture of Cement	38.56	47.98	1.71[3]	1,685	1.36	Yes	Manufacturing/Intermediate	High
5.		Iron and Steel Making						Yes	Manufacturing/Intermediate	High
	3713	Iron and Steel Foundries	78.05	83.08	N/A	114	0.09			
	3719	Iron and Steel Basic Industries	94.95	99.78	N/A	707	0.57			
6.	3843	Manufacture and Assembly of Motor Vehicles	72.56	78.46	1.81[4]	1,264	1.02	Yes	Manufacturing/Consumer Good	Medium

Notes:

1. Border vs. Domestic Price
2. Percentage share to total value added of manufacturing sector, except telecommunications
3. 1987 data
4. For 1800 CC Displacement CKD

Sources of data:

Concentration Ratio on Value Added by Four-Digit Philippine Standard Industrial Classification (PSIC), 1988. National Statistics Office
Hongkong Foreign Trade Statistics, 1988.

II CONCEPTUAL FRAMEWORK

STRUCTURAL ADJUSTMENT AND INDUSTRIAL ORGANIZATION

Interaction Between Macroeconomic and Microeconomic Environment

Rather than take only a micro view of the issue on barriers to entry in Philippine enterprises, the Barriers to Entry Study also takes a broader view by considering the interaction between macroeconomic and microeconomic environment.

The reason is obvious. The interaction between macro and micro aspects suggests that each sets the limits to the success of the other. This insight will hopefully increase the policymakers' appreciation of the need to accompany macroeconomic reforms with microeconomic reforms. In fact, structural adjustment calls for this.

Structural adjustment seeks to change the structure of the economy to improve the balance of trade and the efficiency of the economy over the medium term. The intention is to increase the supply of tradeables, increasing both exports and import-substitutes. While others have argued that structural adjustment is basically a macroeconomic problem (e.g. Montes 1988), the SGV Study Team views it also as encompassing microeconomic problems because it concentrates on increasing the efficiency of market signals as a guide to an improved allocation of resources.

Thus, aside from macroeconomic variables such as fiscal deficit, the investment-savings gap, the current account deficit, the rate of inflation, and the exchange rate, structural adjustment often involves institutional and policy reforms such as trade liberalization, reduced role of the state in the economy, fiscal reform, privatization, financial market reforms, price reforms, market structure reforms, etc. Neglect of the microeconomic aspects of structural adjustment could lead to its failure.

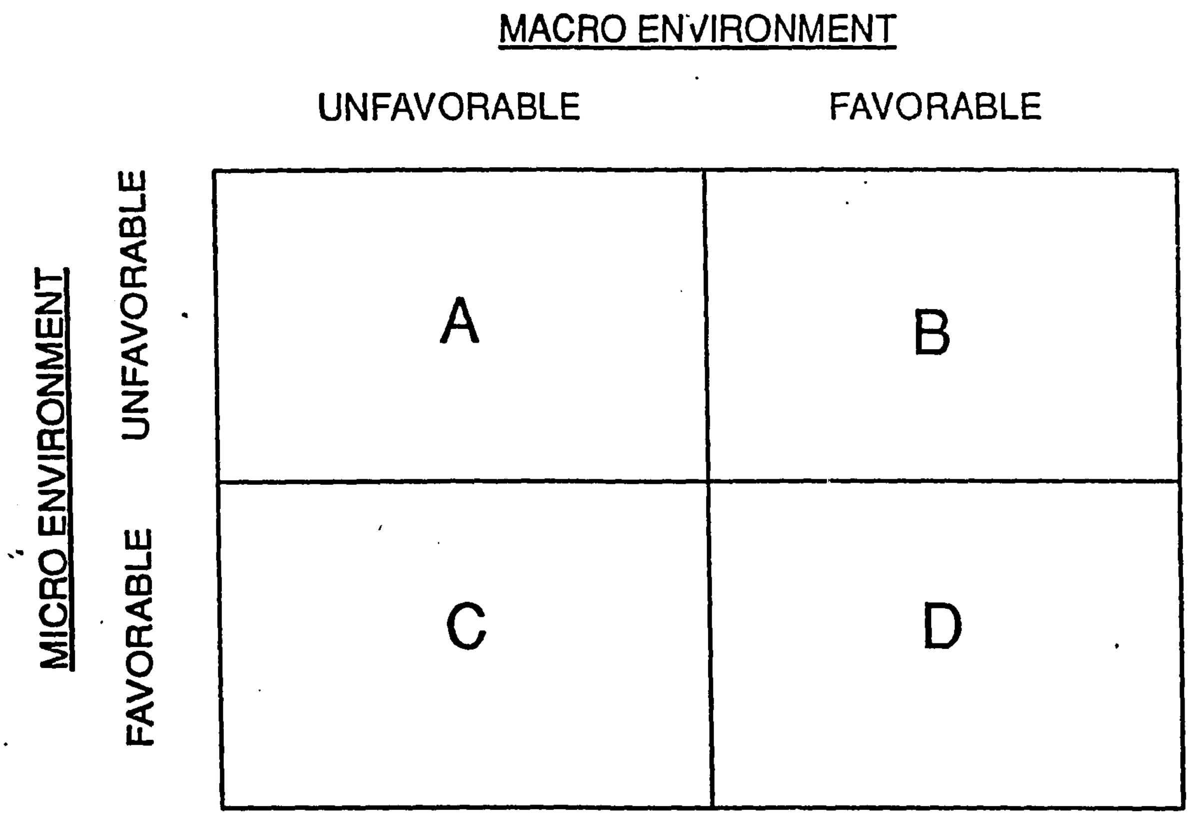
Ranis (1987) eloquently puts it:

> "The typical adjustment package includes some import liberalization and a devaluation, along with more restrictive fiscal and monetary policies. Does this package have to have an inhuman face? Not if the market mechanism toward which one is trying to move is a truly competitive market rather than the kind of oligopolistic structure often faced in developing countries. The fact that devaluations don't stick, or that they hurt vulnerable groups disproportionately, often results from the fact that entrepreneurs do not fit the textbook definition of competitive actors but are in fact noncompetitive rent-seekers. This means the benefits of, for example, devaluation are not passed on to the producers of exports, while the desired negative effect for importers, producers for the domestic market and the elite organized labor force are cushioned by the noncompetitive

features of the private market, as well as by government interventions. While trade liberalization represents the best anti-oligopoly policy, domestic licenses, permits, price controls, etc., often permeate the market and cannot be ignored."

Given the macro-micro interaction, four alternative policy environments can be considered (see **Figure** 2.1).

FIGURE 2.1
INTERACTION BETWEEN MACRO AND MICRO ENVIRONMENT



- The most undesirable situation is **A** in which both macro and micro environments are generally unfavorable to sustainable growth. At the macroeconomic level, trade and fiscal policies are geared towards promoting import-substitution, capital-intensive industries, while the financial system is repressed, i.e., interest rate is kept below market-clearing level, usually below the inflation rate. At the microeconomic level, a host of entry barriers, such as strict licensing requirements, limited allocation of capital, etc., are in place to support the so-called "infant industries." This could be the starting point when a country launches a structural adjustment program.

- The content of such a program could include reforms only at the macroeconomic level, in which case the country moves to **B** where unfavorable microeconomic environment becomes the binding constraint. A clear example of this is the foreign exchange restrictions, while the latter may involve interest rate liberalization. However, at the microeconomic level, barriers to entry still exist. For instance, bank entry remains restrictive, allowing banks to enjoy monopoly power both in the deposit and loans markets. In effect, financial repression is being maintained, causing inadequacy in the supply of funds. This would make entry difficult for potential entrants. This may be reinforced by a fiscal incentives or a capacity licensing system that is discriminatory, such as those that are administered by a body with broad discretionary powers.

- Or it could include only reforms at the microeconomic level, in which case the country moves to **C** where the macroeconomic environment becomes the binding constraint. The example here is that of the complete removal of barriers to entry, such as those mentioned above, but that trade and financial policies are still geared towards promoting importing-substituting industries.

- Or, finally, it could include reforms at both the macroeconomic and microeconomic levels, in which case the country moves to **D**. At the macroeconomic level, this consists of pursuing trade and financial liberalization while the tax burden is imposed uniformly as much as possible to all industries, or at least to all firms within the same industry. If ever fiscal incentives are given, these are made available to all industries or at least to all firms within the industry, whether incumbents or new entrants. At the microeconomic level, all forms of barriers to entry that confer undue advantages to incumbents are removed.

The discussion above suggests an appropriate timing and optimal sequencing of the reforms. In terms of timing, one should not wait for an external environment to get better because it is the whole domestic environment that is distorted by policies. In terms of sequencing, both macroeconomic and microeconomic reforms should be implemented simultaneously since each sets a limit to each other.

Since the 1950s, the Philippines have launched several structural adjustment programs. Those introduced in the 1970s through the 1980s and the present had been inspired by multilateral institutions.[1] However, given the severity of the current slowdown, one could ask why the reforms had failed to take root and conclude that these might have been inappropriate or ill-conceived, at best, inefficiently implemented. One reason for this is that macroeconomic reforms were not accompanied by key microeconomic reforms (i.e., the country opted for **B** environment).

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1 The latest is the proposed "economic integration loan" of US$300-US$500 million from the World bank and other multilateral institutions which is predicated on adoption of such policy reforms as: (a) removal of tariffs for 131 import items, (b) further liberalization of the foreign exchange market, and (c) deregulation of pricing for petroleum products.

Rigidities and Barriers

Structural adjustment policies are undertaken to overcome rigidities that have constrained the growth of the economy. It must, however, be recognized that industrial policies adopted to spur economic development have often been the cause of such rigidities and have been intensely defended by those who have responded to such industrial promotion policies.

For instance, fiscal and credit incentives are offered to entrepreneurs investing in promoted industries. This is usually accompanied by capacity licensing regulation which regulates entry to achieve a balance between supply and demand, invariably resulting in a monopolistic or oligopolistic market structure. The incumbents, who have been comfortably reaping some monopoly rents, naturally would want to preserve this market structure. They will exert every effort such as intense lobbying against liberalization or instituting anticompetitive behavior, like predation or raising expenditures in advertising, to deter new entrants and preserve the market structure. Thus, policy-induced barriers to entry are being reinforced by structural barriers, which would weaken the effectiveness of any structural reform efforts.

There are several cases to illustrate this point. One is the case of trade liberalization which does not result in improved domestic competition because incumbent manufacturers themselves also engage in trade of the same commodities they produce. Another is the case of capacity licensing deregulation which may not lead to improved competition if incumbents end up acquiring new entrants. This clearly calls for new antitrust regulations that need to be instituted together with the new set of policies. Merger, consolidation and acquisition policy needs to be guided by competition policy so that any merger or acquisition would not produce entry barriers.

It must be recognized, however, that there are possibilities that structural adjustment measures run into conflict with microeconomic reforms. A case in point is the privatization program, which may give a few participants within the same industry the opportunities to acquire government-owned corporation that is supposed to be privatized, thereby increasing concentration.

Reform touching on exit barriers is another component of regulatory reforms that must accompany structural adjustment reforms. If investors cannot easily move their resources from one industry to another, or transform them from one form to another (e.g., from capital investment to portfolio investment), then they would have to think hard before making such investments. Thus, exit barriers themselves become an awesome entry barrier. Complicated bankruptcy procedures or weak bankruptcy laws discourage potential entrants. Stringent labor laws also serve as a barrier to exit.

This is clear in the case of foreign investment. Stringent regulations on profit and capital repatriation discourage foreign investors from investing in the country.

The major thesis in this study is that **barriers to entry and exit in Philippine industries have continued to persist.** While some of them are admittedly structural barriers, others may have been induced by policy. Whether structural or policy-generated, barriers to entry and exit need to be addressed by policy since they set a limit to the effectiveness of any macroeconomic structural adjustment efforts.

THEORETICAL CONSIDERATIONS

Theory on Barriers to Entry

The literature on the theory on barriers to entry is extensive. Joe Bain (1956) began research on entry barriers, which was expanded into a theory of barriers by other industrial organization economists.[2]

In general terms, discussion on entry barriers postulates that various elements of the industry structure can impose disadvantages on entrants (new competitors) relative to incumbents (existing players). Barriers tend to limit the number of players in a particular sector and thereby serve to stifle or restrict competition. Cushioned from competition as what happens in monopolistic or oligopolistic market structures, the dominant firms can earn supranormal profits. In Bain's original work, therefore, an entry barrier refers to **anything that allows incumbent firms to earn excess profits** (i.e., keep prices above minimum average costs). Bain mentions three sources of this advantage to incumbency: (a) scale economies, (b) product differentiation, and (c) absolute cost advantages.

Most definitions of an entry barrier are variants of Bain's. The definition of entry barriers as any disadvantage borne by a new entrant but not by an incumbent is basically reflected in the works of Stigler (1968) and Baumol and Willig (1981). The latter authors, along with John Panzar, later developed the theory of "contestable markets" which shows how monopolies or oligopolies act as perfect competitors if threatened by new entrants.

As the above definition stands, this is both a virtual positive and a virtual normative definition. It easily leads to a measure of whether an entry barrier exists -- i.e., whether there is a divergence between price and average cost -- and a normative suggestion that, if and when this prevails, economic welfare is being diminished. Facing little or moderate threats from outside, the incumbents often have no incentive to innovate or to provide quality services or products. Contrastingly, in competitive markets or contestable monopolies, the incumbents are forced to improve *x*-efficiency. Hence, lowering or reducing barriers leads to increased consumer welfare and efficient use of resources.

This definition may be broadened to include **any expenditure or cost incurred by a potential entrant into an industry which is not borne by the incumbent, making entry unprofitable** (Ferguson 1974). On the other hand, it may be limited to include only **those situations where the additional expenditure or cost imposed on the entrant leads to a distortion from a social welfare viewpoint** (Von Weizsacker 1980).

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2 The *Handbook on Industrial Organization* (1989), edited by Richard Schmalensee and Robert D. Willig, offers a comprehensive survey of recent theoretical, empirical, and policy research developments in industrial organization.

Gilbert (1989) tends to be more normatively lenient and agnostic. He proposes to define a barrier to entry simply as **rent that is derived from incumbency** and advises a separation between a positive discussion of the determinants of entry and exit and their welfare implications:

> "An incumbency advantage does not necessarily imply that welfare would be improved by encouraging entry. In many of the examples discussed...., quite the opposite is true. Consumers may be disadvantaged if forced to switch to another supplier. Industry costs would increase if entry eroded the benefits of economies of scale or learning. Entry prevention may result in both lower prices and lower costs than would occur if entry were allowed".

While the literature inspired by Bain's approach tends to focus on the structural factors impeding entry, more recent writing focuses on the dominant firm's conduct in determining whether a particular situation merits attention from a normative viewpoint. For example, a situation where there are large fixed costs and therefore scale economies may or may not degenerate into a monopoly, depending on how the incumbent firm responded to a potential entrant.[3]

Once the behavior of the dominant firm is recognized as influencing the assessment of entry barriers, however, the line between this and predation or monopolization becomes less easy to draw. Gilbert (1989) makes the distinction that:

> ". . . .predation deals with strategies whose rationality depends on inducing exit and preventing future entry, whereas entry deterrence is concerned with the conditions which impede capital mobility".

In other words, the imposition of barriers to entry refers to an *ex ante* strategy directed against potential rivals, while predation is directed against actual rivals, whether this leads ultimately to their exit from the industry or not. Obviously, however, the full set of rivals consists of both potential and actual, and strategies against them must be determined simultaneously.

As Ordover and Saloner (1989) recognize, actions against actual rivals

> ". . . can have a substantial deterrence effect on potential rivals and, in fact, may only be rational if they have this demonstration effect. Similarly, precommitments made purely for deterrence purposes, such as investment in capacity, may harm existing rivals and facilitate aggressive strategies towards actual competitors. Furthermore, actions that disadvantage actual rivals can, in principle, disadvantage potential rivals as well".

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[3] This was pointed out in Gilbert (1989). Consider two firms facing identical cost functions $C = F + cx$. Then if they acted as perfect competitors, only an equilibrium with one firm would result. However, if the dominant firm kept prices fixed in the face of entry, then more firms could be accommodated, despite scale economies. Thus the efficacy of the entry barrier would itself depend on the behavior of the incumbent.

Ordover-Saloner Framework

The framework suggested by Ordover and Saloner (1989) is a simple but useful starting point in illustrating issues of entry and predation.

Consider a two-period model and denote by a^t and A^t, respectively, the actions of the incumbent and the rival/entrant in period t (= 1,2). This may be price or quantity or some more general action-vector. Exit by the rival may be defined as $A^1 > 0$, $A^2 = 0$. Entry prevention is depicted by the combination of a stipulated $A^1 = 0$ and a choice of a^1 and a^2 such that $A^2 = 0$ as well in the resulting equilibrium.

Current profits of the incumbent are denoted by h^1 (a^1,A^1), depending only on current actions by both firms. Second-period (discounted) profits of the incumbent h^2 depend on the previous actions (a^1,A^1), as well as the contemporaneous actions (a^2,A^2); but the latter also depend on what has occurred before, i.e. (a^1,A^1). Therefore, total incumbent profits $h = h^1 + h^2$ can be written out as:

$$h = h^1(a^1,A^1) + h^2(a^2(a^1,A^1), A^2(a^1,A^1); a^1,A^1)$$

Differentiating this with respect to the first-period own-action by the incumbent yields:

$$dh/da_1 = (dh_1/da_1) + (h^2a_2)(da^2/da_1) + (h^2A_2)(dA^2/da^1) + h^2a_1 = 0$$

The first term is the direct consequence of first-period action on contemporaneous profits without strategic considerations. If there are intertemporal elements in the decision, then the last term becomes operative as well.

Clearly, strategic anticompetitive behavior is incorporated in the second and third terms, which would not be present under competitive conditions, since the naive conjecture would then be that $dA^2/da^1 = h^2a2 = 0$. The second term, for example, includes the possibility that current action may make future aggressiveness more profitable. The third term may denote the possibility that current aggressiveness (e.g. capacity expansion) may cow the rival in the next period, with salutary effects on future profits, in the extreme leading possibly to exit or non-entry, $A^2 = 0$.

On the other hand it would be wrong to conclude that a dominant firm always behaves uncompetitively whenever it acts as though dA^2/da^1 and h^2a2 were not zero. An example would be research and development (R&D) investments or capacity expansions which would be profitable only if the other firm were to exit or fail to enter.

The key point to be learned here is the difficulty in making summary normative judgements in evaluating behavior of dominant firms. What is required, in fact, is a closer specification of opportunity costs of resources.

Policy-Induced vs. Industrial Organization-related Barriers to Entry

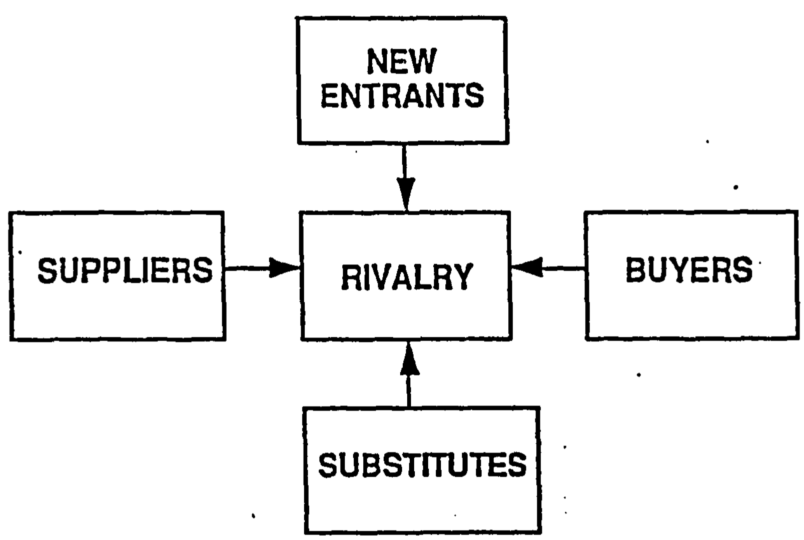
A distinction may be made between (a) "policy-induced" barriers to entry and (b) those that are structural or related to "industrial organization". This seems to proceed from Bain's notion of an industrial structure that *ipso facto* is prone to entry barriers, such as those which are characterized by scale economies, absolute cost advantages, or product differentiation.

The operational source of the distinction seems clear enough -- it is based on the source of the initiative for the erection of the entry barrier: it may either be from the government itself, or may originate from the incumbent firm(s).

The distinction appears to have become sharper in the early 1980s when Harvard economists led by Michael Porter and Richard Caves (1979, 1980) began using industrial organization concepts in formulation of corporate strategy. Stressing the dynamics of competition, Porter views entry barriers as an **inherent feature of the industry that new entrants must attempt to overcome even as incumbents try to use them to strengthen their position.**

In his Five Forces Model, Porter cites "threat of new entrants" as one of the competitive forces shaping competitive strategy. The other forces include: the bargaining power of customers, the bargaining power of suppliers, the threat of substitute products or services, and the positioning among the current rivals (see **Figure 2.2**).

FIGURE 2.2
PORTER'S FIVE FORCES MODEL



Source: *Competitive Strategy* by Michael E. Porter

Porter says that the collective strength of these forces determines the ultimate profit potential of an industry. A new entrant or an incumbent must formulate strategies to deal with competitive forces, defend itself against them and influence them in its favor. In this regard, Porter's view on entry barriers differs from the normative view and almost coincides with Gilbert's. Barriers are a fact of corporate reality.

Porter expands Bain's sources of entry barriers to six: (a) cost advantages independent of size, (b) capital requirements, (c) product differentiation, (d) access to distribution channels, (e) economies of scale, and (f) government policy.

In a subsequent book (1985), Porter stresses the imperative to sustain competitive advantage. Individual firms must in fact put up barriers to maintain their competitive edge. This is to be regarded in a dynamic sense. Firms need to create cost advantages, invest hugely in their businesses, strive for scale economies, differentiate their products or services, and/ or gain access to choice distribution channels. Otherwise, a challenger, whether an established firm or a new entrant, will easily prey on their market shares. Porter further extends his work to global industries (1986) and to individual nations (1989).

Research inspired by Porter went further in the field of competitive strategy analysis. Yip (1982), for instance, advances the role of established firms as potential entrants and modifies Bain's original theory by stressing the heterogeneity of competitive strategies. Yip claims that the most important way in which entrants can overcome barriers is to use a competitive strategy different ("heterogeneous") from that of the incumbents. Heterogeneous strategies can arise from: (a) opportunities to exploit radical technological or other environmental changes: (b) opportunities to avoid direct competition; and (c) opportunities to negate barriers directly.

In summary, what differentiates the corporate strategist from the economist, at least of the normative type, is the former's focus on strategies of the firms to overcome barriers or to erect barriers to defend their positions. Corporate strategists tend to dwell on industrial organization-related barriers. On the other hand, economists tend to focus on identifying barriers, particularly policy-induced ones, and seeking to dismantle or eliminate them to foster competitiveness. Normative issues accordingly intrude.[4]

Political economy considerations, however, tend to blur this distinction. Above it can be seen that the presence of Bain-type entry barriers was neither a necessary nor sufficient criterion for normative conclusions, and that incumbent-firm behavior was important in completing the information. If this is true, however, certainly the use of the legal and political process in order to erect entry barriers is also a possible tool in an incumbent's arsenal. Then the distinction breaks down.

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[4] See Frischtak who discusses entry barriers within the context of competitive markets (Frischtak 1989; Frischtak, Hadjimichael, and Zachad 1989; see also Doz 1986). According to Frischtak, less developed countries often put up entry barriers to spur industrial development. Policy tools such as franchises, capacity licensing, incentives, etc. are used to create capacity, regulate entry of firms and attempt to balance supply and demand. As the industrial sector matured, some countries progressively removed the barriers and increased exposure to competitive forces. But, in most countries, barriers to entry have solidified. Removal of barriers, Frischtak says, and the introduction of a balanced and effective mix of competition policies are required if countries are to move efficiently beyond the initial stages of industrialization.

Possible Barriers to Entry

In the Bain tradition, there are three sources of entry barriers: scale economies, absolute advantages, and product differentiation (see **Box** 2.1 for Bain's and Porter's taxonomy of entry barriers).

Scale economies, sunk costs, limit pricing

The basic strand of literature arising from this includes various versions of the "limit-pricing" model. The incumbent in the initial period must choose and commit itself to a price and output which it must maintain in all subsequent periods.

The possibility exists, therefore, of choosing output and price in order make entry unprofitable for the rival. If the required limit-price is not too low,[5] then the incumbent can maximize profit by setting price equal to the former and preventing entry. Otherwise, entry-prevention may be unprofitable and is allowed.

Offhand, therefore, one should expect to find opportunities for this to prevail in industries which are generally regarded as "natural monopolies," e.g. telecommunications, energy distribution, etc.

A related barrier to entry is to be found in the case when capital requirements, or sunk costs, are large. Under those circumstances, unit costs will tend to decline with output (e.g. consider the total cost function $C = F + cx$, where F is fixed and c is average-variable cost).

An obvious way large sunk costs can be a barrier to entry is if the capital market is imperfect and not all firms have access to financial resources. (It is better to keep this separate, however, and discuss it under absolute advantages, since in the event the financially privileged firm has an advantage in many other industries -- even those requiring a large amount of circulating capital -- and not just the one with large capital requirements).

The more distinct reason why large sunk costs represent a potential entry barrier is the credibility they lend to the threat the incumbent can confront the entrant with, i.e. considering the magnitude of the investment that has been committed by the incumbent, the entrant perceives it as more likely for the former to respond aggressively to attempted entry. For the same reason, the holding of excess capacity is also used to signal possible aggressive behavior.

More recent writing emphasizes the role of the conjectures held by the potential entrant. Excess capacity and sunk costs (as well as the limit-pricing based on them) are effective only if they are a convincing signal of the threat of retaliation from the incumbent.

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5 In the Bain tradition, the limit price itself depends entirely on demand and technology; therefore whether the entry barrier is high or low depends only on demand and technology. Behavior here is reduced to the two-period profit-calculus.

Box 2.1 Bain and Porter Classifications of Barriers to Entry

Bain Classification	Porter Classification
• Absolute cost advantages	• Cost advantages independent of size
Existence of patents and legal restrictions	Existence of patents, Government subsidies
Preferential access to factors of production	Proprietary technology, Access to raw materials Assets purchased at pre-inflation prices, favorable locations
Higher cost of capital	• Capital requirements
• Product differentiation	• Product differentiation
Brand loyalty	Brand loyalty
Control of superior product design	
Ownership of favored distributive channels	• Access to distribution channels
• Economies of scale	• Economies of scale
	• Government policy

Sources: Bain (1956); Porter (1979)

Otherwise, if, say, the entrant were to disregard this and act as a Cournot or a perfect competitor, limit-pricing would be to no avail in deterring entry, and the incumbent might just as well charge the monopoly price in the initial period (Spence 1977). One upshot of this is to de-emphasize the dependence of aggressive behavior on market-technology configurations; in fact such incumbent behavior may in theory happen anywhere.

In another context, excess capacity has also been used as a lobbying leverage to secure legally-imposed restrictions to entry in an industry (e.g. the "measured capacity" criterion used by the BOI). A potential wrinkle to this argument from a developing-country context is the common observation that the domestic market is typically small. Given the inward-orientation of most firms, therefore, it is not only the nontradeables sector but also tradeables which are likely to be affected by domestic market constraints on size, given the technology (typically developed-country in origin) employed.

To that extent, the industries which may be prone to limit pricing may not be confined only to those exhibiting decreasing average costs, but even those with U-shaped cost curves. Under these circumstances, excess capacity need not represent *ex ante* strategic behavior on the part of the firm, and it is even conceivable efficiency may require entry restriction rather than encouragement. On the other hand, we must recognize that given the structurally imposed fact of excess capacity, it is more likely for the incumbent firm to practice aggressive pricing strategy against a potential entrant, thus raising entry barriers.

Another important question to investigate is the extent to which regulatory agencies, in enforcing maximum rates, have facilitated (or colluded) in limit pricing strategies that favor incumbent firms. This is discussed under government policy below.

Absolute advantages

Some factors may confer absolute advantage to incumbent firms independently of scale or size, such as: (a) learning or experience; (b) patents or control of technology; (c) control of supplies used by rivals or potential entrants; (d) control of output markets; (e) complementarities in production or consumption, among others.[6] (a) to (d) are evident; an example of (e) on the other hand is the phenomenon of "network economies" (i.e. referring to the observation that some services or products become more valuable to the individual the more others are hooked onto the same system, e.g. telecommunications systems or even VHS vs. beta-format videotapes).[7]

Absolute advantage is also the category under which some policy-induced entry barriers affecting costs are likely to fall. For example, tariffs, quotas, and other government-granted privileges which tend to raise costs to potential rivals should be classified here.

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6 One should note that these same elements which economists find suspect in terms of limiting competition are precisely those which corporate strategists or business writers strive to create or preserve.

7 This tends to argue that standardization may be in the interest of the dominant firm. On the other hand, product differentiation, as will be discussed later, may also serve to protect a niche against competitors.

A decision should be made whether to regard low-cost imports as part of potential entrants. If so, then the analysis would be simple: tariffs, quotas, and other nontariff measures may harm potential entrants by directly increasing their marketing costs. If attention is restricted to domestic rivals, however, it is not the domestic producers of imported output which are harmed, or whose entry is impeded.

Upon closer inspection, legal privilege (e.g. a franchise or license) pertains to some factor of production which is available to the incumbent but not to the entrant. It is important to observe that even demonstrable cost asymmetries between incumbents and potential entrants are not necessarily undesirable from the viewpoint of social welfare (Gilbert 1989).

The illustrative example is that of a patent held by the incumbent but not by the entrant. Whether the patent is an entry barrier or not depends on whether the potential entrant can earn nonnegative profits after paying for the opportunity cost of the scarce resource.

In the Philippine context, another important source of absolute advantage is access to credit. It has long been recognized that in developing countries there is widely differing access to credit, owing partly to the close relations existing between large banks and favored firms. Access to finance may be an important source of absolute advantage of larger firms in an industry, relative to existing or potential smaller rivals. Preliminary work in this direction has been done by Tan (1991).

Product differentiation

Bain regards this as the most prevalent factor determining the ability of firms to prevent entry. This is most likely to occur in consumer goods industries, supported by advertising. On the other hand, in terms of structural importance in a development context, consumer goods industries may be less strategic. Much of this is accomplished through advertising and marketing expenditure.

The effect of advertising and marketing expenses is twofold: (a) developing consumer allegiance and (b) enhancing scale-related economies. The extent to which the first effect represents a case for remedial social policy is quite open to debate. In each instance a judgement must be made whether differentiation and its associated advertising is "excessive" or "wasteful" from a social viewpoint, just as rent-seeking might be. One manifestation of this is the question whether competition would not benefit from some standardization of parts and accessories.

This may certainly be raised in the case of government sponsored programs such as the automobile industry. On the other hand, advertising and marketing may be pursued simply in order to slide down average costs curves, in this way realizing the scale-related cost advantages.

Predation and Monopolization

As mentioned above, predation and monopolization are not strictly speaking included in barriers to entry, although we have argued they are comprehended by broader anticompetitive strategy against both potential and existing rivals and there is broad correspondence between forms of entry barriers and predatory actions. For completeness, some examples of monopolization moves are listed here, based on Ordover and Saloner's (1989) discussion:

Price predation and battles for market shares

When applied to predation, aggressive pricing strategies, classified under "unfair competition," have the goal of reducing market share for the rival and, in the extreme, forcing exit, rather than forestalling entry, as in the case of entry barriers.

There are at least three theories underlying anticompetitive pricing strategies. The more familiar is the "long-purse." A second is "reputation," and the last is the "signalling." In the case of the "long-purse," access to financial resources, whether one's own or borrowed, is the key variable allowing a firm to engage in the predation game.

Nonprice anticompetitive strategies

These include predatory product innovation; vertical restraints, and pre-announcements.

Other predatory moves

Analogous to absolute cost advantages in the case of entry barriers, predatory moves can also include putting rivals at a disadvantage, such as by raising costs or reducing demand for the rival's products (e.g. there are occasional accusations among softdrink manufacturers that their rivals buy up and break empties in order to disrupt supplies). Generally items mentioned under Absolute Advantages may be interpreted also as predatory moves (e.g. "sleeping patents," exclusive supply contracts, etc.).

Legal Barriers to Entry

Thus far, discussion has focused on potential barriers to entry and predatory moves which have been initiated by the incumbent firms as part of their strategy to deter entry or drive out or disadvantage actual competitors.

Another source of entry barriers, however, may be the legal system itself. This includes licenses, franchises, quotas, and other privileges which may cause a cost asymmetry between incumbents and potential entrants and allow the former to earn supranormal profits.

Regulation itself may provide the occasion to restrict entry. The demand for regulation becomes especially plausible given the "overcrowding" of industry observed in developing countries and government itself may impose restraints.

Another set of rules that serve to restrict entry are nationality requirements, although there has been some move to relax this in the manufacturing sector with the enactment of the Foreign Investments Act. From the viewpoint of predation, rate of return regulation may encourage a firm to expand capacity more than is called for *a la* Averch and Johnson (i.e. so long as the regulated rate of return is larger than the cost of capital to the firm).

Finally the legislature or the courts may themselves intervene to block entry or confer advantages to incumbents.

Political Economy Aspects

Of course, from a political economy angle, the distinction between policy-induced entry barriers and those induced by strategic behavior by the incumbent may disappear. As mentioned in the previous section, it cannot be ruled out that the use of the political and legal process itself is a strategic tool in the hands of the dominant firm(s). In the past, most especially during the Marcos regime, this direct relationship was used with respect to various supply contracts and franchises from the government.

Expectedly in a predatory state, government interventions are intended to enrich or entrench certain segments of society, the so-called "cronies", no matter how these measures may be given a cloak of legitimacy. The government exhibits anticompetitive behavior, carving out entire areas of business activities as government or crony monopolies or simply taking over firms through sequestration, prejudicial policies, and redefinition of property rights.

In situations like these, the predatory government itself put up entry barriers to favor "special groups" or uses its full coercive powers to strike down incumbents and allow entry to its allied interests.

A democratic polity raises a different set of issues and circumstances. Nonetheless, it is likely that "special groups" or actors in the political and economic processes will act to protect their interests by lobbying against reforms or emasculating them. Policymaking or introduction of reforms reflects a complex interaction among interest groups that stands to win or lose from the proposed reforms.

Given the probable market outcomes, ostensible winners or losers will attempt to exert pressures for or against the policy decisions even as the government tries to resist (or welcome) such pressures (E.S. de Dios 1988; Mercado circa 1988; Joskow and Rose 1989). At least in a democracy, every economic agent can in theory exercise some kind of pressure on the government.

III ADJUSTMENT REFORMS AND MARKET STRUCTURES

ELEMENTS AND ACCOMPLISHMENTS OF STRUCTURAL PROGRAMS

Since the early 1980s, the Philippines has been undergoing structural adjustment reforms. This section describes the elements and accomplishments of structural programs in the following policy categories: trade and industrial policy, agricultural policy, foreign exchange management, financial market liberalization, wages and prices, fiscal and monetary policy, privatization, and incentives and credit policy. The focus is on policy actions without regard to policy results since the latter would involve a more complicated analysis separating effects of policy actions from those caused by extraneous factors.

Trade and Industrial Policy

As pointed out by Pante and Medalla (1990), "trade policy in the Philippines is very much intertwined with industrial policy. With its pervasive effects on the relative price and incentive structure, it has a direct bearing on industrial structure and development".

Trade reforms initiated in the 1980s brought about a major restructuring of Philippine industries. It had two major components: tariff reform and the import liberalization. Both should have been implemented simultaneously were it not for the 1983-84 balance of payments crisis. Thus, while the tariff reforms proceeded as scheduled, the import liberalization program was deferred until 1986. Between 1985 and 1990, the number of regulated items was reduced from 1,924 to 443, or from 34 percent of total Philippine Standard Classification Code (PSCC) lines to 8 percent. **Table** 3.1 shows the types of regulation for the remaining products subject to quantitative restriction.

In 1991, the government embarked on another round of tariff policy reforms with the primary aim of simplifying tariff administration and promoting competition. The first attempt which was embodied in Executive Order (EO) No. 413 proposed immediate and one-time substantial cuts in tariff rates. However, it was met with stiff resistance from the private sector and even disagreements among various branches of the government.

The modified version which is embodied in EO 470 allows a five-year transition period beginning in July 1991 and retention of the 50 percent tariff protection on some 200 products instead of the four-tier tariff structure of EO 413 ranging from 3 percent to 30 percent. Clarete (1991) has indicated that with EO 470 fully implemented, the government will be moving towards a sector-neutral effective tariff protection policy and reduce the anti-export bias of tariff policies.

Table 3.1
Products Under Trade Control
(As of February 1990)

List	Product Group	No. of Items	Regulating Agency	Type of Regulation
A.	Others (game cocks, telescopic sights stamps, swords, title certificates advertising matter, tie clips, gun stocks)	1	CB	Banned
	Nonmetric measuring devices	1	Bureau of Product Standards	Non-limiting -- to check if imports use the metric system
	TOTALS	2		
B.	Animal and meat products	31	BAI	Meat processors allowed
	Coffee	9	CB	Banned
	Fish and fish preparations	36	BFAR	Banned
	Sugar	3	NASUTRA	Only the government may import
	Fertilizers	19	FPA	Accredited importers allowed
	Potatoes, onions, garlic, cabbage	4	CB	Banned; BPI allows these for seedling purposes
	Antibiotics	23	DOH	Regulation is meant to monitor the grades imported
	Consumer durables/electric products	33	BOI	Program participants allowed
	Raw materials, parts and components of CEP's	73	BOI	Program participants allowed
	Trucks and buses	11	BOI	Program participants allowed
	Motorcycles	10	BOI	Program participants allowed
	Car and jeeps	20	BOI	Program participants allowed
	Used tires	2	BOI	Banned
	Coal and derivatives	3	ERB	Imports of grades not locally available are allowed
	Used clothing	1		
	Refined petroleum products	15	ERB	Imports of grades not locally available are allowed
	Spare parts for Cars, Trucks, Utility Vehicles, Motorcycle, and Diesel Engines	24		Program participants allowed
	Vessels and Appurtenances	1	MARINA	Regulation is meant to monitor the quality of imports
	Brand New Trucks and Engines, special purpose vehicles	7	DTI	Program participants allowed
	TOTALS	325		

Table 3.1 (Continued)
Products Under Trade Control
(As of February 1990)

List	Product Group	No. of Items	Regulating Agency	Type of Regulation
C.	Used tires	6	BOI	Banned
	Dangerous drugs (No specific PSCC lines since these are under generic names)		DOH	Banned
	Chemicals for explosives	10	PC-FEU	Legitimate users allowed
	Other chemicals (acetic anhydride, sodium cyanide, chlorofluorocarbon)	3	DOH	Legitimate users allowed
	Color reproduction machines	3	CB	Banned
	Used vessels and warships	5	MARINA	Regulation is meant to check quality of imported vessels.
	Ammunition and firearms	28	PC-FEU	Legitimate users
	Animals and animal effects	40	BAI	Livestock, meat processors
	Pesticides	7	FPA	Legitimate users allowed
	Rice and corn	12	NFA	Imported only by the government
	Games and Amusements	2	CB	Banned
	TOTALS	116		

Note: Two items from List A, Brand new trucks & Engines, special purpose vehicles and Games & Amusements were transferred to List B and List C, respectively.

Source: Trade and Industry Utility Staff, National Economic and Development Authority

Agricultural Policy

The recent reforms in agricultural policy complement industrial policy changes. Price and quantitative controls as well as levies and taxes were phased out. Also, some barriers to entry were eliminated.

Specifically, the deregulation in this sector includes the following:

- the lifting of the copra export ban and export taxes on coconut oil and other agricultural products;
- the abolition of monopsonistic arrangements in sugar and coconut trading;
- the liberalization of fertilizer importation and distribution;

- the removal of retail price ceilings on rice, poultry products and pork;

- the opening of import trade in wheat, wheat products, and animal feeds to the private sector;

- the divestment of the National Food Authority (NFA) from non-grain activities and the reorientation of its primary function to price stabilization of rice and corn;

- the discontinuation of many direct lending programs and the consolidation of separate commodity-specific funds into the Comprehensive Agricultural Loan Fund; and

- institutional reforms affecting various agencies involved with agriculture.

To a certain extent, the reforms, particularly the dismantling of inefficient and restrictive market arrangements, reduced market distortions in the agricultural sector.

Foreign Exchange Management

Exchange rate policy had been focused on preventing wild swings of the peso. Thus, monetary authorities actively participated in buying and selling of dollars in the Bankers Association of the Philippines (BAP) trading floor. Since there was much pressure on the peso, monetary authorities had to use up its reserves to defend the peso. This was complemented by the high interest rate policy.

Thus, only small changes in the official exchange rate occurred over time, resulting in overvaluation of the peso. A number of exchange controls also existed covering repatriation of capital, foreign exchange retention limits for export receipts, import of foreign currency into the country, etc.

Very recently, monetary authorities made major changes in foreign exchange regulations including the following:

- full and immediate repatriation and remittance privileges for all types of investment;

- relaxing restrictions on the buying and selling of US dollars and other convertible currencies including the entry and exchange of foreign exchange;

- raising exporters' retention limit of their foreign exchange earnings to 40 percent which could be used for direct payment to foreign suppliers of equipment, machinery and raw materials and interest and amortization of CB-registered foreign loans; and

- making more dollars available to exporters under the foreign currency deposit system.

Effective 2 April 1992, commercial banks will be covered by a new regulation on foreign exchange positions which will be limited to percentages of their unimpaired capital (not exceeding 25 percent in case of overbought position and 15 percent in case of oversold position). Concomitant with this new regulation is the launching of the off-bourse foreign exchange trading. All these reforms will eventually result in a market-determined exchange rate.[1]

Financial Market Liberalization

The liberalization of the financial markets started with the 1980 financial reform package that sought to foster competitive conditions in the financial markets and improve the availability of medium- and long-term funds to the industrial sector.

The reforms included the removal of interest rate ceilings on all types of loans and deposits and the restructuring of the financial system so that different types of banks could compete with each other. A more relaxed rule on equity investments in allied and non-allied activities was introduced so that financial institutions can compete in various areas of banking and finance either through their own departments or affiliates.

More reforms were introduced during the second half of the 1980s including the adoption of a uniform, market-oriented rediscount rate by the Central Bank (CB) which effectively ended its selective credit control policy, a clearer definition of the role of the government-owned financial institutions, and transferring the developmental function of the CB to government-owned financial institutions so that it can concentrate in its task of stabilizing the economy.

In the 1990s, rules on bank entry and branching have been substantially relaxed. The CB stepped up auctions of bank branch licenses. The CB, however, still uses the concept of "overbanked areas" to restrict entry in certain places.

Other much-needed reforms still remain unacted upon by the Legislative Branch of the government. These are: the creation of an independent Central Monetary Authority, strengthening prudential regulations and bank supervision, improving depositor protection, reduction/elimination of intermediation taxes and entry of foreign banks into the domestic banking system.

Wages and Prices

The wage policy of the government is aimed at increasing nominal wages by using certain instruments such as minimum wage regulation, public sector wage decisions, and institutional apparatus of collective bargaining, conciliation, and arbitration procedures. The fixing of minimum wages used to be highly centralized and hence, highly politicized.

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[1] Key informants say that at best, what will emerge is a partially deregulated foreign exchange market as certain controls on exporters' earnings have been retained. This is at least a major step toward linking up the hitherto closed domestic forex markets with "borderless" financial centers of the world.

This was changed in 1989 with the promulgation of RA 6727, creating Regional Wages and Productivity Board with tripartite representation in each region of the country. The Boards are empowered to determine increases in minimum wages in their respective region taking into consideration certain factors such as demand for living wages, cost of living, fair return on capital invested, productivity, among others. This new arrangement practically depoliticize the process of determining increases in minimum wages appropriate for each region.

Price policy had undergone considerable change. Up until 1984, socialized pricing had been used extensively in basic commodities, petroleum products, electricity, transport and house rent. Toward the second half of the 1980s, however, price ceilings on all basic commodities including rice and corn were lifted. They were temporarily re-imposed on seven prime and essential commodities during the Gulf crisis.

In April 1991, price ceilings on all basic commodities were already removed. In November 1991, the price controls on cement were lifted. On the other hand, prices of petroleum products, electricity rates, and transport fares are still regulated by government.

Fiscal and Monetary Policy

The tax reforms initiated during the second half of the 1980s were designed to attain the following objectives:improve the elasticity of the tax system; promote equity by ensuring that similarly situated individuals and firms bear the same tax burden; promote growth by withdrawing or modifying taxes that impair incentives to produce; improve tax administration by simplifying the tax system; and promote tax compliance.

With respect to direct taxation, the following specific measures were adopted:

- partial shift to global system of personal income taxation;
- imposition of a uniform 20 percent final tax on passive income;
- withdrawal of income tax exemption of franchise holders;
- imposition of a uniform 35 percent corporate income tax rate;
- tax amnesty on undeclared income;
- increased private motor vehicle tax;
- increased personal exemption levels, thereby giving tax relief to families below the poverty line;
- separate taxation of married couples; and
- elimination of double taxation of dividend income.

As regards indirect taxation, a general rate of 10 percent value added tax (VAT) was imposed in lieu of varied taxes applicable to fixed taxes.

There are remaining issues, however. One is that the proposed institution of ceilings on certain allowable business deductions, which would minimize the erosion in revenue yield that the global approach would likely produce, was not adopted owing to the strong lobby from various professional and business groups.

Also, the revenue base of the VAT system was narrow because of so many exemptions.

Finally, the government must squarely address the ballooning consolidated budget deficit, which is estimated to reach in 1992 to ₱37 billion or 2.6 percent of Gross National Product (GNP). Almost all of it (about ₱36 billion) will come from the losses of the CB, which in the past had been forced to conduct fiscal functions (i.e., providing credit subsidies to priority sectors and providing forward exchange cover to key industries) and made to assume huge amount of foreign debts contracted by some government corporations.

At present, the CB is not able to conduct independent monetary policy since its management of liquidity depends to a large extent on the actions of the fiscal sector.

Privatization

The Marcos administration saw a proliferation of Government Corporations (GCs), which increased from 37 in 1965 to 301 in 1986. The efficiency levels of these corporations had been very low compared to the rest of the economy. The Aquino administration sought to privatize many of these corporations. The present privatization program has basically two components, namely the government corporate sector component and the nonperforming asset component.

To improve the performance of the government corporate sector, the Aquino administration introduced some reforms with the following three components: strengthening of policy framework; rationalization of the government corporate sector; and operational improvements of retained corporations.

To implement the privatization, the Committee on Privatization (COP) and the Asset Privatization Trust (APT) had been established. The former, which is composed of inter-agency membership, has been tasked to formulate policies and recommendations on privatization for submission to the President who will make the final decision, while the latter, which is composed of five members drawn from the private sector, has been tasked to manage, conserve and market assets transferred to it for disposal. Aside from APT, disposition entities (DEs) have been identified. These are actually parent GCs authorized to privatize their own subsidiaries or acquired assets.

Of the 301 GCs, 123 were approved for privatization, 78 to be retained and the remaining to be regularized, consolidated, abolished or converted to private status. As of September 1991, only half of the 123 government corporations approved for privatization were fully or partially sold, generating a total of ₱9 billion for the government.

With regard to the nonperforming assets, accounts were already sold with a total value of ₱43 billion, including the ₱9.8 billion winning bid for the 67 percent stake in the Philippine Air Lines (PAL). Still, a number of big-ticket items such as the National Steel Co. (NSC), Manila Hotel, Paper Industries Corporation of the Philippines (Picop), Manila Electric Co. (Meralco) and a number of commercial banks have not yet been partially or fully privatized. Many of these corporations compete with those owned by the private sector.

While the Aquino administration remains committed to privatization, the progress of implementation has rather been slower than expected. Of course, there are some valid reasons for this such as court injunctions instigated by former owners (e.g. Jacinto family over NSC) or losing bidders [e.g. the complaint of the Philippine Association of Private Telephone Company Operators (Paptelco) against the Digital Telecommunications of the Philippines (Digitel) as seen in the case study on telephone services], poor investment climate and poor conditions of assets for sale. But there are other huge impediments that the government could easily address such as reluctance of managers to give up powers, reluctance of government corporations to divest of their subsidiaries especially if they are profitable, and slow approval and bidding process.

The new law extending the life of APT until August 1992 has further complicated the job of APT to sell transferred assets. First, the law requires APT to dispose government properties only through cash payments, disallowing the acceptance of Land Bank of the Philippines (LBP) bonds as payments and payment by installment. Second, it prevents the dismissal of workers by whoever buys any of the government companies to be sold. And third, it prohibits APT to sell at discounted rates.

Incentives and Credit Policy

Fiscal incentives for investment offered by the BOI are an important tool in influencing industrial structure. Many of these incentives are designed to encourage investment in the so-called "infant industries".

The 1987 Omnibus Investment Code (also issued as EO 226) has replaced earlier investment laws. Its objectives are, among others: domestic investment promotion, augmentation of direct foreign investment, export promotion, regional development, employment enhancement and technology upgrading. It is important to point out here that under the 1987 Omnibus Investment Code, income tax holidays with a duration ranging from 3 to 8 years have replaced the performance-based incentives (on net local content and net value added) of earlier investment incentives law (BP 391).

The fiscal incentives offered by the 1987 Code (i.e., eligible investments are provided exemption from duties and taxes on certain inputs and expenditures, as well as a general tax holiday) could have substantial impact on the internal rate of return of a project (Manasan 1988).

Credit programs, especially those that are managed by government financial institutions such as Development Bank of the Philippines (DBP) and the Philippine National Bank (PNB), have also a substantial impact on industrial structure. In the past, special credit programs were established to promote specific industries.

More recently, however, especially after the rehabilitation of government financial institutions, the character of the credit programs managed by government financial institutions has changed. In particular, they are no longer targeted to specific industries but rather to a broad potential clientele. In addition, they are no longer used as instruments for supporting protected industries.

An example of these programs is the Industry Restructuring Project of DBP which re-lends funds borrowed from the World Bank to any industries except those that are subject to price control, subject to quantitative restrictions or have excessive effective rates of protection (see **Table 3.2** for the list of industrial subsectors not eligible for financing).

Table 3.2
Industrial Subsectors Not Eligible for Financing*

A. Existing Industries

1. Subject to Price Control:

   Cement and Cement Products

2. Subject to Quantitative Restrictions:

   Cars and Spare Parts
   Trucks and Buses and Spare Parts
   Motorcycles and Spare Parts
   Pesticides
   Consumer Durables as per list agreed under IICP (Loan 3123-PH)

3. Excessive ERP Protection (unless indicated otherwise by Domestic Resource Cost Indicators):

	ERP (in %)
Paper and Paper Board Products	105
Refined Cooking Oil and Margarine	143
Publishing and Printing	92
Rubber Footwear	138
Plastic Products (Domestic Market)	91
Insecticides	84
Soap and Detergents	125
Cosmetics and Toilet Preparation	107
Glass and Glass Products	80
Fabricated Metal Products	88
Batteries	107
Furniture and Fixtures Made of Metal	139

B. Industries Not Yet in Existence

These would be eligible for financing, except if (a) they were protected by quantitative restrictions (QRs); (b) by tariffs, whereby the nominal tariff exceeded the current maximum rate of 50 percent; and (c) no agreement existed between the Government and the industry concerned about the time frame for phasing down of protection below a level of 80 percent of effective rate of protection (ERP).

* Subsectors will be dropped from the list as suitable action programs are implemented.

In 1991, the Foreign Investments Act was promulgated, liberalizing entry of foreign investment into the country. More specifically, foreigners are now allowed to invest as much as 100 percent equity in areas excluded in the negative list. House Bill (HB) No. 35068 aimed at liberalizing the entry of foreign banks into the domestic banking system was introduced but not passed in the last Congress. This would have complemented the Foreign Investments Act.

General Assessment

In summary, a number of major structural reforms have been implemented particularly during the Aquino administration. Many of these are aimed at freeing the market, increasing competitiveness and levelling the playing field so that participants could compete on an equal ground.

As pointed out, however, there are still a number of issues that has remained unresolved or not being adequately addressed by the government. Nonetheless, substantial progress has already been made. Interestingly, progress was not necessarily an economic turnaround but there was instead progress in the formulation of laws that promote reform.

PHILIPPINE MARKET AND INDUSTRY STRUCTURES

Market Concentration

Among the important "stylized facts" regarding Philippine industry, one that has been repeatedly documented by studies since the 1960s and the 1970s (see especially Lindsey's work) is the high degree of industrial concentration. A few firms account for the bulk of industry sales, employment, or assets, even for broadly defined sectors. **Table** 3.3 below gives the share of large firms in total sales of broad sectors based on the 1983 census. "Large" firms (i.e. those with 200 or more employees) accounted for 57 percent of total manufacturing employment, 68 percent of census value-added, and 78 percent of sales. The concentration for some in some sectors is even much higher.

Table 3.3
Distribution of Employment, Census Value-Added, and Sales
by Firm Size (1983)
(Values In Million Pesos)

Firm Size	No. of Firms	Employment	Value-Added	Sales
200 or more employees	717	503,498	₱ 38,835	₱ 127,092
100-199 employees	505	70,884	4,959	13,629
10-99 employees	4,512	127,450	5,182	20,369
less than 10 employees	50,313	188,735	1,611	1,859
Totals	56,047	888,567	₱ 56,760	₱ 162,950

Source: Census of Establishments 1983, National Census and Statistics Office.

The most commonly used measure, however, is the concentration ratio in terms of census value-added. Industries with high concentration (defined here as a three-firm value-added concentration ratio of 70 percent or more) for the years 1983 and 1988 are shown in Table 3.4.

Table 3.4
Industries with High Concentration Ratios*
1983 and 1988
(In Percent)

Code	Industry	1988	1983
3111	Meat	74.52	64.61
3112	Milk	109.49	90.69
3113	Dairy products	75.05	89.83
3114	Fruits and vegetables	93.90	92.91
3116	Crude coconut oil	47.88	88.44
3117	Vegetable, animal oils	84.26	67.49
3125	Desiccated coconut	57.11	70.32
3127	Coffee	97.77	99.61
3129	Food, n.e.c.	72.56	45.40
3132	Wine	34.75	88.31
3133	Malt liquors	73.36	52.18
3141	Cigarettes	95.94	95.94
3143	Tobacco	95.27	95.18
3149	Tobacco, n.e.c.	100.00	62.63
3213	Made-up textile goods	64.12	75.36
3214	Carpets and rugs	49.78	87.62
3216	Impregnated and coated fabrics	86.66	65.32
3217	Upholstery filling	88.30	85.85
3219	Textiles, n.e.c.	94.65	-
3229	Wearing apparel, except footwear, n.e.c.	72.85	59.80
3231	Tanneries	25.05	75.35
3313	Hardboard and particleboard	98.88	95.90
3314	Wood preserving	76.82	91.30
3315	Millwork	97.97	73.05
3323	Box beds and mattresses	75.79	44.35
3325	Windows, door screens	54.61	70.75
3411	Pulp, paper, paperboard	92.20	95.89
3419	Paper articles n.e.c.	16.60	97.68
3511	Fertilizers	99.63	86.13
3513	Synthetic resins, plastics	76.00	47.89
3514	Pesticides, etc.	68.24	68.70
3530	Petroleum	98.70	100.00
3540	Petroleum and coal products	78.71	84.77
3551	Tire and tube	51.27	85.34
3552	Rubber footwear	69.31	77.38
3610	Pottery, china, earthware	68.05	89.01
3620	Glass and glass products	83.51	64.72
3691	Structural clay products	91.25	74.47
3711	Blast furnaces, steel making	86.76	78.71

Code	Industry	1988	1983
3712	Steelworks and rolling mills	68.42	84.79
3713	Iron and steel foundries	78.67	48.41
3719	Iron and steel basic industries, n.e.c.	94.95	97.14
3722	Nonferrous smelting and refining plants	99.99	69.89
3723	Nonferrous rolling, drawing, extrusion mills	90.95	75.92
3724	Nonferrous foundries	38.61	80.34
3729	Nonferrous metal basic industries, n.e.c.	100.00	92.70
3816	Nonelectric lighting and heating fixtures	74.26	73.66
3821	Engines and turbines	84.98	100.00
3825	Office, computing machinery	45.63	74.75
3833	Electrical appliances and housewares	68.37	76.21
3834	Primary cells and batteries	99.17	79.01
3835	Electrical accumulators	83.89	90.71
3836	Electrical wires and wiring devices	77.70	65.04
3839	Electrical apparatus and supplies, n.e.c.	84.87	67.69
3842			90.24
3843	Motor vehicles	72.56	60.27
3846	Motor bicycles and bicycles	91.74	83.91
3847	Aircraft	99.10	100.00
3851	Professional, scientific, measuring, and controlling equipment, n.e.c.	98.60	83.16
3852	Photographic and optical instruments	100.89	100.00
3853	Watches and clocks	100.10	54.31
3902	Musical instruments	81.38	80.48
3903	Sporting and athletic goods	69.28	92.32
3904	Surgical, dental medical, and orthopaedic supplies	76.68	99.95
3905	Orthopaedic goods	98.72	99.32
3906	Toys and dolls	86.42	70.10
3907	Stationers,' artists,' and office supplies	76.12	89.41

Notes: * Three firm ratios of 70 percent or more.
n.e.c. - not elsewhere classified

Source: National Statistics Office

Between the two periods, of 52 lines which had high concentration in 1988, 37 lines or 71 percent also had high concentration ratios in 1983, while the other 15 lines were additions to the list. On the other hand, there were 65 subsectors with high concentration ratios in 1983, of which 29 (or 45 percent) had dropped from the list by 1988.

New lines where high concentration was recorded between 1983 and 1988 include: meat products; animal oils; food n.e.c., malt liquors; tobacco n.e.c.; coated fabrics; wearing apparel; box beds and mattresses; synthetic resins; glass; iron and steel foundries; electrical wires and wiring devices; electrical apparatuses and supplies n.e.c.; motor vehicles; watches and clocks.

On the other hand, among the subsectors which dropped out of the list between the two periods were: crude coconut oil and desiccated coconuts; wine; made-up textile goods, carpets and rugs; tanneries; millwork; windows, doors, and screens; paper articles; tires and tubes; pottery and china; leather shoes; toilet preparations; steelworks and rolling mills; nonferrous foundries; transport equipment n.e.c..

While the fact of high concentration in the organized private sector is hardly disputed, what is more important from a policy viewpoint is whether this carries any normative significance or presents an instance for policy intervention. The answer, however, depends closely on the explanation preferred for the existence of high concentration.

Explanations for High Concentration

Several explanations for the phenomenon of high concentration in the Philippine context have been advanced. Among these are:

Scale

First, the possibility that concentration results from the size of the domestic market relative to the minimum efficient scale of technology employed in some industries. Economies of scale (more accurately, subadditivity of the cost functions) themselves imply that the efficient industry-configuration should be a concentrated one.

The additional insight from a development viewpoint is the reminder that subadditivty[2] of a firm's cost function is a local concept. Subadditivity over the entire range of output is not a necessary condition for the efficiency of concentration; all one needs is subadditivity in the relevant range of demand. This would imply that the set of industries (given the same technologies) for which concentration is efficient may be larger in developing than in developed countries.

[2] A cost function $c(y)$ is strictly sub-additive at y if, for output vectors $y^1, y^2, \ldots, y^k$ such that $\Sigma_i y^i = y$, it is true that $c(y) < \Sigma_i c(y^i)$. (See, e.g. Panzar 1989).

Heavy industries particularly steel, industrial chemicals, cement, and transport assembly are generally conceded as being characterized by significant scale economies. Unrestricted entry into a limited market would therefore drive all firms up their unit-cost curves, lowering expected long-run profits. Then, as has occurred historically, price-wars may be triggered to drive out competitors. The observed concentration is then simply the natural consequence of such a weeding-out and readjustment of capacity to actual demand.

As for the social cost of such concentration, it should be evident this would be minimal where the market is contestable.[3] A monopoly may exist to serve all of existing demand, yet earn no long-run rents, simply because there is a threat of entry. Even allowing for overinvestment and the consequent redundancy of capacity need not be a problem, so long as costs are internalized by private agents.

Such a simple picture is modified, of course, as soon as -- more realistically -- sunk costs are allowed, since these confer some advantage to the incumbent. Then entry may be blocked (entrants cannot practice "hit-and-run" tactics) and rents to the incumbent need not be driven down.

In addition, the government itself may internalize the problem by intervening to prevent shakeouts from taking place among firms, in effect preventing the rapid adjustment of capacity to demand. Some reasons for this may be a concern for short-run stability of employment and incomes for factors committed to the industry; another reason may be that the government itself has become financially involved in the industry and is anxious to salvage the value of its investments.

Privilege, protection and promotion

Second, concentration may have been the result of a deliberate government policy of protection and promotion of some industries. Here three instances should be distinguished:

- The most straightforward is the case of the traditional natural monopolies, e.g. telecommunications, power distribution, interisland shipping, in which the government explicitly grants monopoly status *ab initio*. Banking can fall under this category.

- A case midway is that of favored industries which are the subject of explicit promotion programs. Examples of these were the "progressive manufacturing programs" for cars, trucks, and motorcycles, or the government's program for an integrated steel mill and for synthetic fiber manufacturing.

- A third and similar case is that of "troubled" or "distressed" industries, for which the government has designed special programs such as "rehabilitation". Textiles and cement are cases in point.

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[3] A market is perfectly contestable if an equally efficient entrant is unable to find a combination of price and outputs that enable it to enter and earn a profit (Gilbert 1989).

Historically the principal instruments used have been protection against foreign competition, fiscal incentives, chiefly through incentives granted by the BOI, as well as regulatory bodies which have implicitly or explicitly regulated entry [e.g. Philippine Cement Industry Authority (PCIA), Iron and Steel Authority (ISA), and Maritime Industry Authority (MARINA)].

What is common to these regulators is that the government's explicit or implicit adoption of a policy to restrict entry for some stated public purpose. The rationale behind many of these regulations is not always clearcut but an attempt at a taxonomy can be made.

In the case of most franchised utilities subject to regulation such as telecommunications or transport, an advantage is allowed the incumbent through a monopoly status in exchange for a commitment to provide services based on some measure of adequacy and reasonableness of price. Rates are regulated and some cross-subsidies from more to less lucrative markets are implied.

The argument against allowing competition in such areas is twofold:

- First, it is typically argued (often by incumbents themselves) that entry in the presence of scale economies would encourage duplication and thus inefficiency. What should be noted is that this in itself does not constitute an argument against preventing private-sector initiative from setting up an alternative. What it does amount to really is an argument against providing public subsidies to potential entrants.

- The more relevant argument against entry in this case would be the possibility of the new entrant skimming off the top and making cross-subsidization impossible. This argument holds, of course, assuming the rate regulation is binding and the incumbent has not in fact been earning supranormal profits. Even if it were, however, it would be difficult to argue that the optimal response of the authorities should be to allow entry rather than to tax away excessive profits.

A different rationale is involved in the restriction of entry in industries which do not have a pronounced public-goods character yet are promoted. Fiscal and trade protection, such as quotas and tariffs, and a preferred exchange rate, amount to subsidies to selected firms and industries which, for some reason, are deemed desirable for the country to have from a developmental -- e.g. infant industry -- viewpoint.

The literature on the incidence and effects of these policies -- in connection with static allocation effects -- is sufficiently rich to allow us to do no more than mention them in passing (see especially Bautista and Power 1979; Medalla 1989; Manasan 1988). While in the course of structural adjustment some progress in changing that system has been made, various indicators suggest that protection continues to be high (Table 3.5).

Table 3.5
Measures of Protection in Manufacturing
(In Percent)

	1985	1988
Manufacturing		
Effective Protection (Book Rates)		
Exportable	-3.26	-0.47
Importables	53.43	45.72
Nominal Protection (Book Rates)		
Exportable	-2.28	0.00
Importables	28.49	30.50
Nominal Protection Pd/Pb		
Exportable	-2.22	0.00
Importables	45.77	44.15

Source: Medalla 1989.

That body of literature has established fairly well that the protective system has tended to favor import-substituting manufacturing over exportables and agriculture; that fiscal incentives have had a capital-cheapening effect; that both have sustained industries which tend to inefficiency in a static allocation sense. It is also suggested but not as explicitly discussed (though this is the main concern of this report) that the same system of protection and incentives has facilitated industrial concentration.

The fiscal incentives provided by the BOI under the Investment Priorities Plan (IPP) constitute entry barriers to the extent they convey substantial absolute advantages to firms fortunate enough to avail of them. Since the Omnibus Investments Code of 1987 uses the concept of "measured capacity", the delisting of an industry from the IPP implies that later entrants are deprived of privileges similar to those enjoyed by incumbents. It has been estimated the fiscal incentives from BOI could raise the rates of return to availing firms from between 10 to 12 percentage points, which is a formidable advantage (Sumulong 1992).[4]

[4] Manasan as cited in Medalla (1989) has a lower estimate.

The system of tariff and nontariff protection against imports can also have the effect of encouraging or strengthening concentration. The most straightforward is the case of tariff protection. When average price at the optimal scale of a domestic plant is above border price, a tariff that raises landed cost to equal the average domestic price serves to establish the industry. If domestic demand at the tariff-inclusive price is large enough to accommodate several firms, then tariff protection may protect against foreign competition but still permit competition among local producers and, in this sense, have no direct effect on (domestic) concentration.

But in the light of the discussion above on demand-technology relations in developing countries, there will be many instances where a few firms will suffice to serve the market hitherto served by imports. For this reason, tariff protection may be found to be correlated with concentration.

On the other hand, under small-country assumptions, a tariff leaves little room for the exercise of market power by a domestic producer, since the tariff-inclusive price sets an upper bound on domestic price. The scope for monopoly-pricing increases with the height of the tariff until the tariff-ridden price exceeds the monopoly price, and the domestic monopolist can charge what the market will bear.[5]

Nontariff measures, which until recently have been the more prevalent form of protection in the Philippines, are distinct from tariffs in their effects on existing market power. While tariffs compel even domestic monopolists to act as price-takers (albeit confronting a tariff-ridden price), the setting of quotas leaves a monopolist a residual demand upon which market power can be exerted. Offhand, therefore, one should come to expect that market power by incumbents would be stronger in the presence of quotas.

Generally the larger the quota on the competing foreign output, the smaller the scope for market power. An exception to this is provided by the example where domestic producers themselves are given the sole right to import under the quota (as has happened, for example, in the case of cement). Where domestic unit costs exceed the border price, a larger quota benefits the producers, who may actually make higher profits by substituting imports for their own production. Apart from stabilizing prices, the practice of raising quotas in the face of shortages -- especially when the import privilege is given to the incumbents -- is also a means of discouraging new entrants.

A similar enhancement of incumbent's privileges occurs in the automotive industry. New participants are allowed to import a certain number of virtually completely- built automobiles [known as semiknocked-down (SKD) units, lacking only tires and batteries] and sell these at the tariff-ridden domestic prices, in effect an assignment of a quota.

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5 As the tariff-ridden price increases, quantity supplied by the monopolist falls, since it is better able to exercise market power. (On this, see Helpman and Krugman 1989)

As the moves to lower the average level of protection and eliminate nontariff measures succeed, one should find a diminution of concentration, if not market power, in the industries referred to. What would make for a more significant change in indicators of industrial concentration in the case of tradeables, however, is not so much the addition of new producers in existing importables industries, but rather the emergence of more export-oriented sectors and firms serving a larger market.

The situation of industries oriented mainly to the domestic market which have no immediate export prospects is more complex. Government encouraged the emergence of such strategic or infant industries, typically but not always with financial involvement. Overexpansion and excess capacity are the usual private response. A shakeout from a price-war would typically result, but alternatively the government intervenes to save all existing producers through a "rationalization" program. Price targets, typically supported by protection from imports, are set which enable all existing firms to survive despite underutilized capacity. Entry is thenceforth blockaded; the idea is to hold together until the time domestic demand justifies existing capacity. The social cost in this instance is borne by the users who must pay higher prices than necessary to sustain the cartel. Were world prices equal to domestic, this cost would not occur.[6]

The case for government-sponsored "rationalization" programs is not clearly defined. This could be motivated by a desire to stabilize employment and incomes, as discussed above. Another impetus could be the financial involvement of government itself in the distressed industries. This was certainly true in the case of the government's formation of the NSC and, less directly, in the case of the cement industry. Conceivably, the pressure to intervene to preserve all participants and bar entry would be less if the government did not have a financial stake in the industry.

It is in this sense that the practice of granting fiscal incentives is superior as a means of promoting industry than the provision of credit. For such industries, the normative question that must be answered is the same as in the infant-industry test: whether the stream of discounted benefits to be had from the continued operation of the incumbent firms exceeds the current costs to the users, i.e. the difference between domestic and border prices, which represents the implicit subsidy to the incumbents.

Schumpeterian industries

Finally, concentration may be the outcome of some Schumpeterian process, which gives absolute advantages to an innovating firm in the industry, e.g. Republic Asahi Glass Corporation (RAGC) in flat glass manufacturing or San Miguel Corporation (SMC) in beer brewing. (There is still a lively debate, however, on the universal validity of the neo-Schumpeterian hypothesis that size and market power are conducive to innovation.)

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[6] Of course then the government would have to find some other means of subsidizing the distressed industry.

The argument is that the truly dynamic efficiencies under capitalism are to be realized not through competition but through the achievement of the economies of scale. This is argument, for example, for the practice of promoting big firms and conglomerates, as found in Japan and South Korea. As Schumpeter also noted during his time, and judging by the situation in the more-developed countries, size is often associated with the achievement of efficiencies, whether this is due to economies of scale or scope, management efficiencies or investment in R&D.

It has been noted (e.g. Medalla 1989) that an argument similar to this may have motivated the revival of the "measured capacity" concept in the Omnibus Investments Code of 1987. Again, it is an important empirical question whether the present crop of highly concentrated industries in the Philippines represent a response to the same forces, and therefore, whether their continued promotion represents a move towards dynamic efficiency.

Offhand it is unlikely that many industries in the domestic market will manifest such Schumpeterian characteristics. (This assessment may be disputed in the case of some large food producers, however.) Again, however, the least that must be demonstrated is that the source of the incumbent's advantage is founded on some form of absolute advantage in technology, marketing, or management, and not the provision of policy-induced privilege.

Lastly, it is an important empirical question whether the present crop of highly concentrated industries in the Philippines represent a response to the same forces, and therefore, whether their continued promotion represents a move towards dynamic efficiency. While we would concur with the liberal analysis that the concentration in Philippine industry is the outcome of a totally different set of forces than efficiency, this, of course, is quite different from abjuring all future tendency to size as being inefficient.

IV LEGAL FRAMEWORK, POLICIES, AND PROGRAMS

LAWS, POLICIES AND PROGRAMS AS BARRIERS TO ENTRY

As stated in Chapter II, the legal system itself can be an entry barrier. Various laws, policies and programs, including several provisions of the Constitution itself, appear to hinder entry. While some are patently restrictive, most laws might not have intended to produce anticompetitive results. For instance, various government rationalization programs outrightly limit the number of participants; franchises or licenses *a priori* exclude other players. On the other hand, laws which unwittingly might have served as entry barriers include various investment incentive acts that end up as capacity licensing or market reservation tools and price control statutes that act as *de facto* limit prices. Laws on bankruptcy and labor can likewise deter exit of firms and thereby act as entry barriers. Moreover, local government units in principle can likewise block enterprise activity in their locality. **Table** 4.1 gives a summary table of laws which serve as barriers to entry.

The 1987 Constitution and Specific Laws

The 1987 Constitution, has adopted as a State policy the development of a self-reliant and independent national economy effectively controlled by Filipinos. This pro-Filipino stance is reflected in at least seven constitutional provisions[1] which guarantee the economic rights of Filipinos, including "a more equitable distribution of opportunities, income and wealth; a sustained increase in the amount of goods and services . . . for the benefit of the people; and an expanding productivity as the key to raising the quality of life. . ."(Section 1, Article XII, 1987 Constitution).

For this reason, the State seeks to regulate foreign investments in accordance with national goals and priorities, although it recognizes the need to encourage private investments and to provide incentives. In line with the constitutional provisions, the State prohibits any foreign ownership in mass media (Article XVI, Sec. 11) and services involving the practice of licensed profession (Article XIV, Section 14). In addition, the Constitution also authorizes Congress to pass legislation limiting certain areas of investments to Filipino nationals. Various pieces of legislation also prohibit foreign equity in the following areas: retail trade, cooperatives, private security agencies, small-scale mining, and the rice and corn industry. Likewise ceilings on allowable foreign ownership are imposed by the Constitution and specific laws on private recruitment, advertising, exploitation of natural resources (with some exceptions), ownership of private lands, operation and management of public utilities, ownership and management of educational institutions, financing companies, and construction.

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1 See in particular Sections 19 and 20 of Article II and Sections 1, 10, 11, 18, and 19 of Article XII of the 1987 Constitution which separately and collectively provide for the development of a self-reliant and independent national economy effectively controlled by Filipinos and reserves to them certain areas of economic activity.

Table 4.1
LISTING OF LAWS WHICH SERVES AS BARRIERS TO ENTRY

Law	Restrictive Provisions	Remarks
1987 Constitution	Limits/prohibits foreign ownership in certain areas of economic activity Authorizes Congress to pass legislation limiting areas of investments to Filipino nationals	To the extent that foreign investors are potential entrants and domestic competition is weak, nationality requirements may represent significant and direct barriers to entry.
Investment Laws		
New and Necessary Industries Act of 1946 Investment Incentives Act Omnibus Investments Code Investments Incentives Policy Act Omnibus Investments Code of 1987	Granted incentives to certain industries	Although designed to promote industrial development, these investment incentive laws served to limit entry into certain industries defined as "overcrowded", or those in which the capacity of existing plants of firms is already deemed sufficient to meet demand. The grant of pioneer or preferred status favored earlier entrants against rivals. While used to build up capacity in specific sectors, it was a form of capacity licensing and served to protect incumbents from competition.
Foreign Investments Act of 1991	Attempts to liberalize entry of foreign investors within the provisions of the Philippine Constitution. The implementing rules and regulations stipulate the Negative Lists, A, B and C which contain areas of economic activities where foreign ownership is limited to a maximum of 40 percent of the equity capital.	Although the Act attempts to liberalize entry of foreign investors, certain ambiguities in the directions set dilute its competitive effect. Although the use of measured capacity is not explicitly stated, the criteria that "industry is ample to meet domestic demand" and that "sufficient competition exists within the industry" are suggestive of the criteria of measured capacity and overcrowding and seem to favor the incumbent. The law therefore provides a loophole for dicretion on the part of authorities to exclude certain domestically-oriented industries from the scope of the Foreign Investments Act.
Rationalization programs		
Progressive Car Manufacturing Program	Limited the number of accredited car manufacturers to five.	Limiting the number of participants in certain industries serves a direct barrier to entry.
Car Development Program	Further limited the number of accredited car manufacturers to three.	

Other industries		During the Marcos regime, certain economic activities (e.g. coconut and sugar) were reserved for cronies.
Price control laws and policies		
Act 4164 (1934)	Refusal to sell at the legal price was made punishable by law.	While the main purpose of these laws was to protect the consumers or end users, price controls act as entry barriers. They can serve as de facto limit prices, high enough to sustain incumbents but low enough to discourage entrants.
RA 6124	Prescribes fair, just and reasonable maximum prices of essential commodities and establishes a Price Control Council	
PD 1675	Created the Price Stabilization Council (PSC)	
EO 133	Abolished the PSC and transferred its functions to the Secretary of the DTI	
Franchises and licenses to operate	Requires public utility operators to secure franchises and permits either from Congress, the local government or regulatory agencies.	The requirement to secure a franchise and permit to operate in certain industries serves as a direct barrier to entry in these industries.
Laws imposing tariffs and quotas	Domestic industrialists were favored over foreign and non-manufacturing industries in the allocation of foreign exchange through the imposition of tariffs and outright quota on competing imported products.	While the main objective is to nurture domestice infant industries and encourage import substituting domestic firms, the ultimate cost to the economy is distortion in resource allocation and use.
Nationalization laws e.g. Retail Trade Nationalization Act of 1954	Limited the retail trade in rice and corn to Filipino nationals.	The law eliminates foreign competition or competition from foreign-owned firms. While these laws give priority to Filipino nationals, mere nationalization only changes the nationality of the monopolist or oligopolist and may make the industy less competitive than it was before nationalization.
Creation of government owned or controlled corporations	Provided priveleges to GCs not available to private firms.	To the extent that the GCs can draw on the resources of the government in the form of government-guaranteed loans, subsidies, and privileged access to credit and decision-making, they have an advantage that may serve as a deterrent to the entry of private firms.

Reforms of the banking system	Raised the minimum capital requirement of commercial banks and adopted universal banking.	Although the reforms aimed to improve financial market efficiency, strengthen capital mobilization and rationalize market regulations, the effect of the reforms was the merger of banks making the banking sytem more monopolistic or oligopolistic. The entry of foreign banks which can increase competition, the effect was only to reinforce oligopoly as foreign banks mainly bought equity in existing financial institutions. While the CB has relaxed rules on bank entry, the concept of "overbanked areas" similar to the concept of "measured capacity" still restrict entry in urban areas.
Laws as Exit Barriers		
Laws on insolvency and bankruptcy Insolvency Law		The complex procedures and time consuming banckruptcy procedures may make an uncompetitive firms opt to stay put rather than exit. Protracted bankruptcy procedures can serve to discourage potential entrants.
Labor Laws	In case of doubt all provisions of the Labor Code have to be construed in favor of labor.	The provisions restrict the flexibility of employers in downsizing or shutting down altogether thus, discouraging exit and impeding entry of new players. Stringent labor laws can also serve as a barrier to exit.
Local Government Code	Provisions on licensing and zoning	The franchising and permit granting powers can have exclusionary or anticompetitive effects. Provisions on licensing and zoning can bar the entry of an enterprise in a given locality.

Likewise, it is the stated policy of the State to regulate or prohibit monopolies when the public interest so requires, and to disallow any combinations in restraint of trade or unfair competition (Section 19, Article XII, 1987 Constitution). This implies that monopolies may be allowed, given the ample safeguard of public interests. This therefore serves as the rationale underlying the grant of legislative franchises for the operation of public utilities, the enactment of patent and trademark laws, and even for the entry of government in economic activities.

Constitution provisions therefore are intended as -- or can result in -- barriers to entry. To the extent that foreign investors are potential entrants and domestic competition is weak, for instance, nationality requirements may represent significant and direct barriers to entry. As with most political economy issues, however, the dilemma for the policy-adviser is this -- to what extent should the implicit or revealed social preferences embodied in the laws (particularly the Constitution) be taken as givens and to what extent should these be regarded as legitimate objects of reform. In any event, recent legislation has been evolving that tends towards a more relaxed interpretation of the various constitutional provisions on nationality. These are taken up further below under the discussion of the Foreign Investment Act.

Investment Laws as Capacity Licensing Tools

Like other developing countries, the Philippines has enacted laws and adopted policies designed to encourage investments and spur industrialization. While the avowed objective is to attract investments in priority sectors, often these have served to restrict entry, tending to insulate the incumbents from competition and leading to high concentration. There have been several investment acts since 1967 seeking to promote investments through the grant of incentives.

Investment Incentives laws from 1967 to 1987

The policy of giving incentives dates back to the earlier years of the Republic. The very first of this was embodied in the New and Necessary Industries Act of 1946 which granted new and necessary industries exemptions from all internal taxes for a period of four years from the date of organization of the firm.

Subsequent revisions were made in 1953 (RA 901) and in 1961 (RA 3127). In 1967, the Investments Incentives Act (RA 5186) was enacted. It provided a wide range of fiscal incentives and other benefits to firms registered with the BOI. In 1970, the Exports Incentives Act (RA 6135) was passed by Congress. It provided additional incentives for export-oriented firms over and above the incentives they obtained from RA 5186.

Both acts were later amended by Presidential Decree (PD) No. 62 (January 1973) and PD 485 (June 1974). In January 1981, the Omnibus Investments Code (PD 1789) was issued. It integrated and codified RA 5186 and RA 6135 as amended. In April 1983, the legislature passed the Investments Incentives Policy Act (Batasang Pambansa Bilang or BP 391), which modified the incentives given earlier under PD 1789. Some incentives provided under PD 1789 were withdrawn, e.g., accelerated depreciation and expansion reinvestment allowance. However, new incentives were introduced such as tax credit on net value earned and tax credit on net local content of exports.

In 1987, President Aquino issued EO 226, otherwise known as the Omnibus Investments Code of 1987, which aims at attracting new investments, foreign and local, particularly in pioneering industries. There are substantial differences in the incentives under BP 391 and EO 226. For instance, EO 226 grants a tax holiday, which is not available in BP 391. Also BP 391 granted exemption from duties and taxes on importing capital equipment only to export producers in pioneering industries, while EO 226 gives it to all producers, whether domestic or export producer. As a whole it appears that BP 391 is a performance-oriented incentive scheme in comparison to EO 226.

The benefits that firms can derive from the incentive scheme differs according to the nature of the operation of the firm as classified by BOI. Manasan (1989) attempts to assess the impact of the more important provisions of BP 391 and EO 226 on the internal rate of return of hypothetical BOI-registered firms. Under BP 391, tax credit on net local content would provide the largest increment in the internal rate of an exporting firm. For a nonexporting firm, the tax credit on net value earned would yield the largest increment in its internal rate of return. Under EO 226, the tax holiday with maximum extension would provide the largest increment in the internal rate of return of a firm in both the pioneer and non-pioneer activities.

Although designed to promote industrial development, these investment incentive laws served to limit entry into certain industries defined as "overcrowded," or those in which the capacity of existing plants or firms is already deemed sufficient to meet the demand, both domestic and external, for the product.

Central to the delineation of an industry as overcrowded, and hence not eligible for preferential treatment, is the concept of "measured capacity", which is "the estimated additional production capacity needed in a particular sector to supply the market demand for its products". Under the 1967 Act, measured capacity "should not be less than the amount by which the measurable market demand exceeds the existing productive capacity", but neither should it be so much in excess of market demand as to foster overcrowding in the sector or industry. If an industry is included in the "overcrowded" list, government approval is necessary before a firm can embark on an expansion program.

This definition of "overcrowding" at one time extended to 36 sectors, including automotive assembly, beer brewing, cement, flour milling, refrigerators and appliances, and other industries (World Bank 1976). Effectively, the application of "measured capacity" served to preclude potential competition by reserving the markets to the first movers and restricting entry to subsequent players.

The 1967 Act (as well as subsequent investment legislation) also opened to foreign participation some areas that are classified (by the BOI, the implementing agency) as either "pioneer" or "preferred" and were earlier reserved for Filipino nationals.

"Pioneer" or "preferred" status also favored earlier entrants against later rivals. While used to build up capacity in these specific sectors, it was likewise a form of capacity licensing and over time served to protect the incumbents from competition. Moreover, the additional 10 to 12 percentage point impact on profitability from fiscal incentives was a formidable advantage by any standards.

Under BP 391, the concept of measured capacity was de-emphasized as a criterion in the application for incentives. The Omnibus Investments Code, however, continues to refer to this concept, although recent administrative practice has tended to relax application of this rule. The deeper issue, however, is whether the implementing agency ought to retain the discretion to apply it leniently or strictly.

The Foreign Investments Act of 1991

The latest investment law is the Foreign Investments Act (FIA) of 1991 (RA 7042) which is an attempt to liberalize entry of foreign investors within the provisions of the Philippine Constitution. As a general rule, there are no restrictions on extent of foreign ownership of export enterprises (defined as those exporting at least 60 percent of their output). As for enterprises oriented to the domestic market, foreigners are allowed to invest as much as 100 percent, unless the participation is prohibited or limited to a smaller percentage by existing laws and/ or the provisions of the Act. Table 4.2 gives the minimum Philippine ownership of enterprises in some business sectors, as provided by the Constitution and other existing laws.

Section 8 of the Act gives the additional list of investment areas reserved to Philippine nationals, which are activities and enterprises regulated pursuant to law which are defense related and which have implications on public health and morals and areas of investments in which existing enterprises already serve adequately the needs of the economy and the consumer and do not require further foreign investments.

This Act repeals Articles 44 to 56 of Book II (Foreign Investments without Incentives) of EO 226 or the Omnibus Investments Code of 1987. The implementing rules and regulations of the Act stipulate the Negative Lists, A, B and C which contain the areas of economic activities where foreign ownership is limited to a maximum of 40 percent of the equity capital. Included in the Negative Lists are defense-related activities, those having implications on health and morals, small and medium-sized market enterprises (those with paid-in capital of less than US$500,000), export enterprises which utilize raw materials which are depleting natural resources, and those "in which existing enterprises already adequately serve the needs of the economy and the consumer".

The issue is whether the law would lead to significant easing of entry barriers or not, considering its intent to facilitate entry of foreign investors. On the whole, there are provisions in the FIA which are significant enough to make its overall effect pro-competitive.

First among these is the change in orientation towards foreign entry itself. Prior to the FIA the 60-40 percent rule was the standard for most industries, with 100 percent foreign ownership possible only as an exception, mainly under the BOI's system of incentives. This system was in theory open to discretion and uneven application. Under the FIA, however, the openness to full foreign ownership is the rule, with discretion being removed from the BOI. To the extent foreign investors are potential entrants, then this itself is a move towards greater competitiveness.

A less direct but no less significant provision in the FIA tending to improve competition is the new definition and treatment of export enterprises. Under the Omnibus Investments Code, fiscal incentives were given to all export firms and to selected domestically oriented firms (i.e. those included in the Investment Priorities Plan). Competition between domestic and export enterprises was less than functional owing to the requirement that -- to avail of incentives -- export firms needed to export at least 70 percent of their output.

The FIA has now redefined export-orientation to mean a minimum of 60 percent of output exported. Export firms qualify for fiscal incentives (as well as duty drawbacks), although they have still to register with the IPP. At the same time 100 percent foreign ownership is also permitted. BOI discretion has also been significantly reduced, since all export enterprises registering with the SEC are deemed registered *ipso facto* with the BOI (Rule VI Section 2) and therefore eligible for incentives. Altogether the more liberal definition of export enterprises may "spill over" into competition in the domestic market. More firms should now qualify through this route for fiscal incentives and these firms may now sell as much as 40 percent of their output domestically, eroding some of the privileges of earlier incumbents producing solely for the domestic market. (It should be noted that the relaxation of the nationality requirement in this context is only one part of the effect of increased domestic competition.)

On the other hand, certain ambiguities in the directions set by the FIA dilute its pro-competitive effect. The FIA does not use the phrase "measured capacity". However, the industries under List C consist of those in which "existing enterprises already serve adequately the needs of the economy and the consumer and do not require further foreign investments". Among others, the law itself (Section 9b and 9c) as well as the implementing rules (Rule XI, Section 3) use for inclusion in List C the criteria that "industry capacity is ample to meet domestic demand" and that "sufficient competition exists within the industry". These are suggestive of the criteria of measured capacity and overcrowding and thereby seem to favor the incumbent.

Again, implementation is critical. Whether a law turns out to support or hinder competition hinges on the "discretion" of the implementing agency. Given such discretionary power, an implementing agency can promote or obstruct entry, notwithstanding the law's intent.

On the whole, therefore, the FIA is a significant move in the direction of greater competition, although vestiges of earlier concepts of discretionary capacity licensing mute the signals it gives.

Table 4.2
Minimum Philippine Ownership of Enterprises in Some Business Sectors

	Business Sector	Percent
1.	Banking institutions	70
	Private development banks	70
	Rural Banks	100
	Savings and loan associations	70
	Pawnshops	70
2.	Public utilities	
	Authority to operate public utility	60
	Domestic air, commerce, and/or air transportation	60
3.	Finance institutions	
	Investment houses	Majority of voting stock
	Finance companies	60
4.	Government contracts	
	Public works, construction	75
	Supplier of government corporations	60
	Supplier of government agencies	75
5.	Natural resources	
	Private land transfer and conveyance	60
	Lease of alienable land of public domain	60
	Small-scale utilization of natural resources	60
	Lease of coral breeding lands	60
	Lands bordering shores	60
6.	Fishing and other aquatic rights	100
7.	Shipping	60 - 75
8.	Construction	60 - 75
9.	Retail trade	100
10.	Geothermal Energy	60
11.	Others	
	Mass media	100
	Advertising	70
	Educational institutions	60
	Atomic energy facilities	60

Source: Foreign Investments Act of 1991

Other Laws and Programs Deterring Entry

By design or owing to unintended effects, other laws can deter entry. These can be classified into the following:

Various rationalization programs

"Rationalization" refers to the various measures and moves undertaken by the State which aim outrightly to limit, or have the effect of limiting. the number of participants in certain sectors or industries. Rationalization was undertaken in the car truck and motorcycle industries, as well as in the coconut, sugar, banana, and communications industries.

- *Rationalization of the motor vehicle industry.* In car manufacturing, rationalization occurred through the Progressive Car Manufacturing Program (PCMP). Under PCMP, the number of accredited car manufacturers was limited to five from a field that at one time numbered close to 30. This was necessary, according to the program proponents, because of the limited domestic market for cars and to enable the participants to realize economies of scale. To these accredited participants, the government, through the BOI, gave preferential tax, tariff, foreign exchange and credit allocation as well as protection from new or potential competitors.

  There were similar moves for the truck and motorcycle industries.

  PCMP was replaced in 1987 by the Car Development Program (CDP). Under CDP, the number of "favored participants" was reduced further to three. A supplementary provision, however, provided incentives to manufacturers of a "people's car", subject to the government's accreditation. There is a recent move to open the program to luxury cars.

- *Rationalization in other industries.* Critical articles have been written on the various decrees and maneuvers of Marcos and his crony-capitalists to reserve "spheres of influence" and monopolize, often under the guise of rationalization, areas of the Philippine economy: sugar, coconut, banana and communications, to mention a few (see E.S. de Dios 1984; E.S. de Dios 1988; Haggard 1990).

  Through various presidential decrees, close associates of the regimes ("cronies") were able to gain privileged access to credit, information, and other forms of assistance from the government. Canalization or confinement policies also give crony-controlled monopolies the right to buy or sell commodities. Because the cronies were politically well-connected, their presence in certain industries may have served as barrier to entry to other "not-so-favored" capitalists.

  Some of those monopolies have been sequestered, while others were dismantled under the Aquino administration; some may however, still remain, if under different ownership.

Although the rationalization moves are usually seen as pro-monopoly, the entry of the cronies into certain industries may be seen as enhancing competition. But this is so only if their entry takes the form of a new firm and not, as was usually the case, the mere takeover of already existing firms.

Government franchises and licenses to operate telecommunication, transportation, electric, and other utilities

A license or franchise from the government is needed to operate public utilities. Franchises and licenses are instruments through which governments regulate entry into certain sectors which are supposed to be characterized by scale economies or subadditivity of costs. The main purpose and effect of such franchises or licenses is obviously to reserve such areas to franchisee or licensee, and hence exclude others. Franchises are awarded by acts of Congress and are distinct from permits to operate, which are dispensed by agencies regulating public utilities. This fact makes the award of franchises potentially open to wider rent-seeking or political considerations.

The most prominent public utility monopolies are the Philippine Long Distance Telephone Company (PLDT) in telephone services, National Power Corporation (Napocor) in electric generation and transmission, and Meralco in electric distribution and supply in Metro Manila.[2] That franchises represent a distinct entry barrier was illustrated recently when Digitel, the winning bidder for the operation of a telephone backbone in the north was disqualified ex post for having failed to secure a franchise from Congress, although the Department of Transportation and Communication was aware of the fact and had permitted its participation nonetheless.

Protection of new and necessary industries and other government incentives designed to encourage the growth of import substituting domestic firms

Under a panoply of protection, domestic industrialists were favored over foreign and non-manufacturing industries in the allocation of foreign exchange, through the imposition of tariffs if not outright quotas on competing imported products, especially those defined as "non-essential" or "luxury," and similar measures. These measures, occurring mostly in the 1950s, and 1960s, determined the structure of Philippine industry, imparting to it its capital-intensive and oligopolistic nature which persists until the present.[3]

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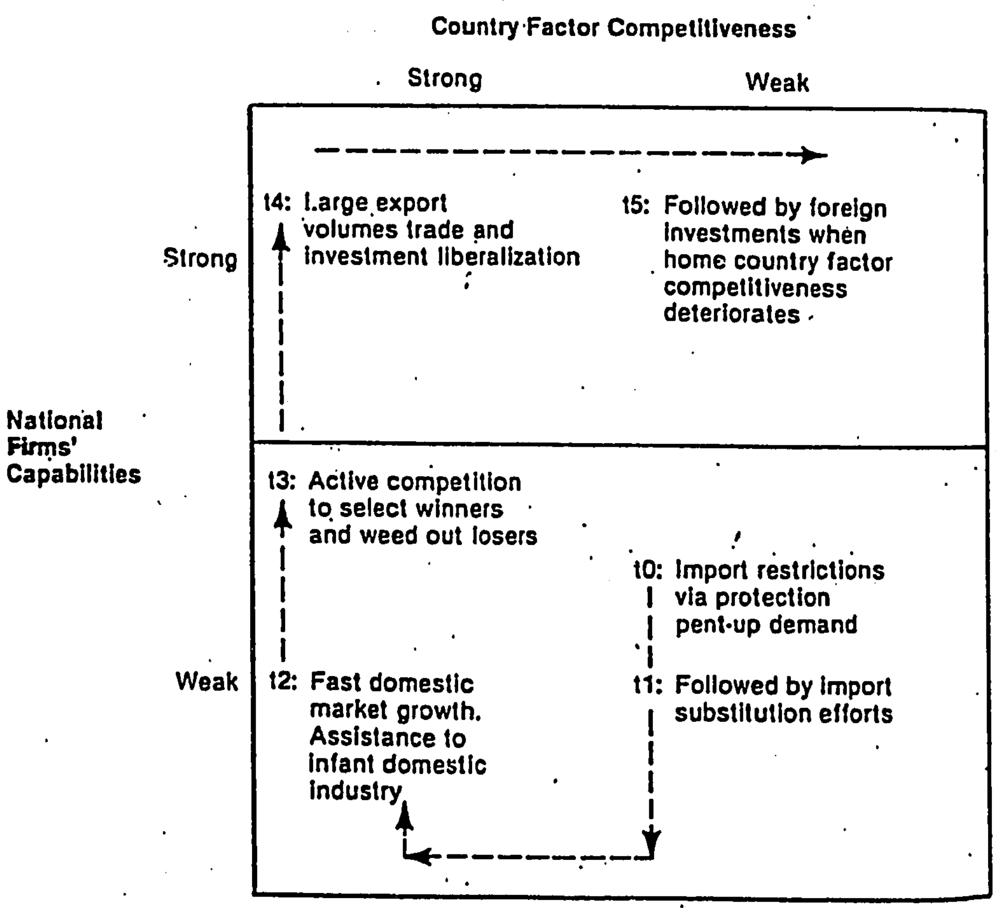
2 One of this engagement's case studies deals about PLDT. The giant phone monopoly managed to fend off rivals for quite a time. It was only recently that regulators decided to accommodate two other international gateways and open up other segments of telephone services to other players. Despite this, the incumbent continues to have tremendous advantages.

3 The case studies on flat glass, cement, polyester fiber, cars, and steel reflect the development of industries behind walls of protection.

The policy objective was of course to nurture domestic infant industries until they grew into internationally competitive ones. Doz (1986) sketches the policies that governments usually follow in this regard (see **Figure 4.1**). First, the domestic market is closed to imports, to create a large repressed demand, then an "infant" industry is promoted and protected. Rapid growth of the domestic market allows domestic firms to achieve efficiency and become competitive. Domestic competition selects winners and weeds out losers. Protection is then progressively decreased, and successful ones are able to compete internationally.

In the Philippines, however, one is witness to the phenomenon of thirty-year old "infant" industries. The ultimate cost to the economy is grave distortion in resource allocation and use.

Figure 4.1
Development of Competitive National Position in a Global Industry



Source: Doz (1986) in *Competition in Global Industries* by Michael Porter (1986)

Various nationalization (i.e. Filipinization) measures intended to reserve certain areas of the economy to Filipino nationals

One of the earliest such measures was the Retail Trade Nationalization Act of 1954, which sought to limit the retail trade in rice and corn to Filipino nationals. Filipinization, in the sense of giving priority in the allocation of government resources to Filipino over foreign nationals, is also provided in other pieces of legislation, including the various investment incentives laws mentioned earlier which specify the percentage of foreign equity that is allowed in certain industries (60-40 percent in favor of the Filipino, in the usual case).

Such nationalization measures can, however, be either promote or prevent competition. On the one hand, since the target of such measures is foreign monopolistic or oligopolistic control of a certain industry, wresting it from such control increases the chance of Filipino nationals, which have less resources and experience, to enter in that industry, making it more competitive.

On the other hand, mere nationalization (in the sense of Filipinization) does not necessarily make the industry more competitive; it merely changes the nationality of the monopolist or oligopolist and may even make the industry less competitive than it was before nationalization, through the elimination of foreign competition or competition from foreign-owned firms.

Government intervention in the economy through the operation of government-owned or controlled corporations

Especially during the Marcos regime, the government corporate sector grew from just 37 in the late 1960s to more than 300 at the start of the Aquino administration. There were government corporations (GCs) in almost every field of economic activity.

To the extent that GCs can draw on the resources of the government in the form of government-guaranteed loans, subsidies, and privileged access to credit and decision-making, they have an advantage that may serve as a deterrent to the entry of private firms. The vagueness in the charters of many GCs does not make entry any less difficult to private firms.

Price control laws and policies

The authority of the Executive to control prices goes as far back as in 1934 (Act 4164, December 1, 1934). The law likewise makes punishable refusing, for the purpose of profiteering, to sell at the legal price, or by hiding, concealing or hoarding the goods or commodities for the same purposes. RA 6124 prescribes fair, just and reasonable maximum prices of essential commodities and establishes a Price Control Council.

During the Marcos regime, the operative law was PD 1675 (February 16, 1980) creating the Price Stabilization Council (PSC), providing for its powers, and providing penalties for violation of price ceilings established by the President upon the recommendation of the Council as well as for violation of the provisions of the decree and the rules and regulations issued pursuant to the decree.

Under the Aquino administration, EO 133 (February 27,1987) abolished the PSC and transferred its functions to the Secretary of the Department of Trade and Industry (DTI) who may exercise the same in emergency situations as he may deem necessary. (It also abolished the Philippine Cement Industry Authority and transferred its policy formulation and planning functions to the BOI, and its implementing functions to the pertinent line operating units of the DTI.)

Before the close of the last Congress, the House of Representatives has ratified the bicameral conference committee reconciling the HB 32696 and SB 1370 which seek to protect consumers from sharp price rises of prime commodities. The report which awaits the signature of President Aquino seeks to safeguard against unreasonable price increases, prevent hoarding, injurious speculation, manipulation and profiteering with respect to the supply, distribution and marketing of essential commodities.

In addition, it sought to ensure the adequate supply of such essential commodities and the stabilization of prices thereof especially during the period of calamity and emergency situations. The act creates a Price Coordinating Council that will coordinate the productivity, distribution, and price stabilization programs of the government and develop strategies for a general stabilization of prices at affordable levels. The act covers a wide range of basic necessities and prime commodities.

The Price Act of 1992 appears milder than previous price control laws and in several aspects formalize the existing policy of the government of imposing price controls only during periods of calamity and emergency. The Aquino administration appears to adhere to the policy of allowing market forces to determine prices of commodities including those considered as basic commodities such as rice, corn and sugar. If ever price controls are imposed, they are held on a temporary basis to deal with emergencies (e.g., Gulf war, natural calamities). Admittedly, however, price controls are still imposed on a very limited number of commodities (e.g. petroleum products) and services (e.g. transportation).

While imposed with the ostensible purpose of protecting consumers or end-users, price controls can act as entry barriers. It will be seen from the case study on cement, price controls can serve as *de facto* limit prices, high enough to sustain incumbents but low enough to discourage entrants.

Various reforms of the banking system

During the 1970s a number of reforms of the Philippine banking system were undertaken. The first reform was undertaken in accordance with the recommendation of an International Monetary Fund (IMF)/ CB Banking Survey Mission of 1972 which noted the proliferation and inadequate capital base of commercial banks. The Mission encouraged bank consolidation and eased regulations on financial institutions. Banks were required to increase their capitalization to ₱100 million.

Regulations to rationalize commercial banks and savings banks were also adopted in 1976 and 1977. But the next far-reaching reforms of the financial system occurred during the 1980s as a result of a 1979 Joint World Bank-IMF mission. The reforms aimed to improve financial market efficiency through competition and scale economies; strengthen capital mobilization especially through long-term capital; and rationalize financial market regulations.

Following the Mission recommendations, the government raised the minimum capital requirement of commercial banks (to ₱500 million), opened up their investment in agricultural and savings banks, and eased regulations on banks in proportion to their scale of business. But the major reform was the adoption of universal banking, which allowed commercial banks to expand their activities and investment in areas they were not previously allowed to go.

The predictable -- and from the standpoint of the policy makers, desired -- effect of the financial reforms during the 1970s was the merger of the banks that could not individually meet the required capitalization, making the banking system more monopolistic or oligopolistic than it already was.

The other effect, however, was the entry of foreign financial institutions into the domestic banking system, as domestic banks turned to them for the required additional equity. In theory, the second result or effect -- i.e. the participation of foreign banks -- could increase competition; in reality, the effect was probably to reinforce oligopoly, as foreign banks mainly bought equity in already existing financial institutions.

The CB has substantially relaxed rules on bank entry and branching. Banks have participated enthusiastically in recent auctions where the CB bidded out scores of branch licenses. Nonetheless, the concept of "overbanked areas" similar to the concept of "measured capacity" still restrict entry in urban areas.

Various bureaucratic procedures

Likewise, various procedures required to put up businesses can pose a barrier. This is shown in **Figure** 4.2 which outlines the procedures that small and medium enterprises would have to follow, from setting up the business to registration of the business (Zamora 1991). This translates to additional transactions costs and often tempts firms to look out for means to short-circuit or manipulate the process.

Figure 4.2
Pre-Investment Considerations and Registration Procedures
for Small and Medium Enterprises

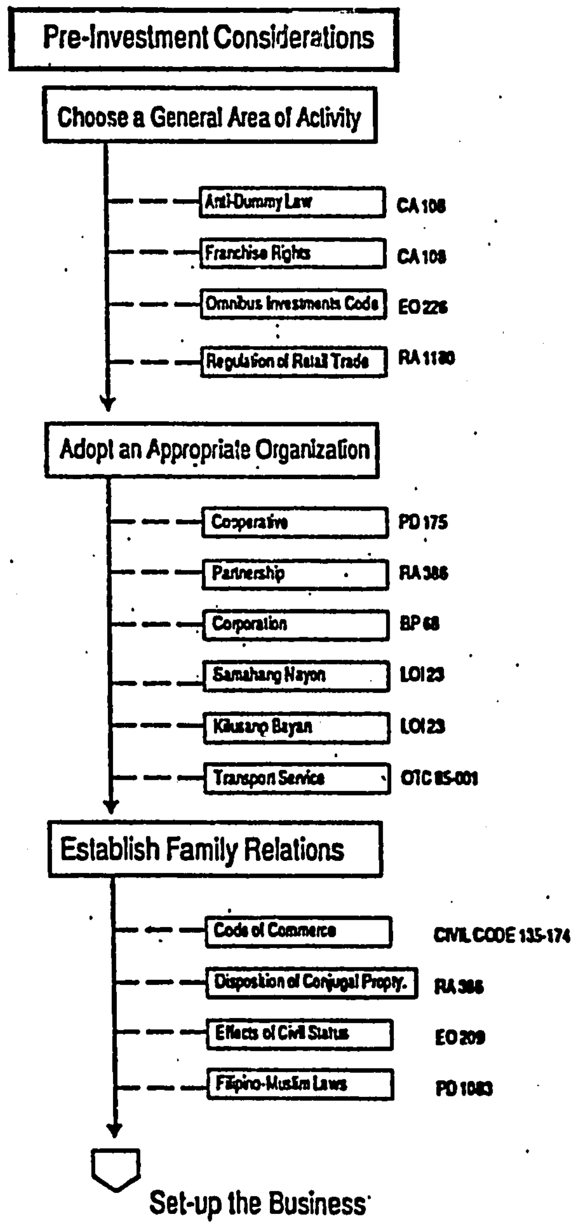


Figure 4.2 (continued)
Pre-Investment Considerations and Registration Procedures
for Small and Medium Enterprises

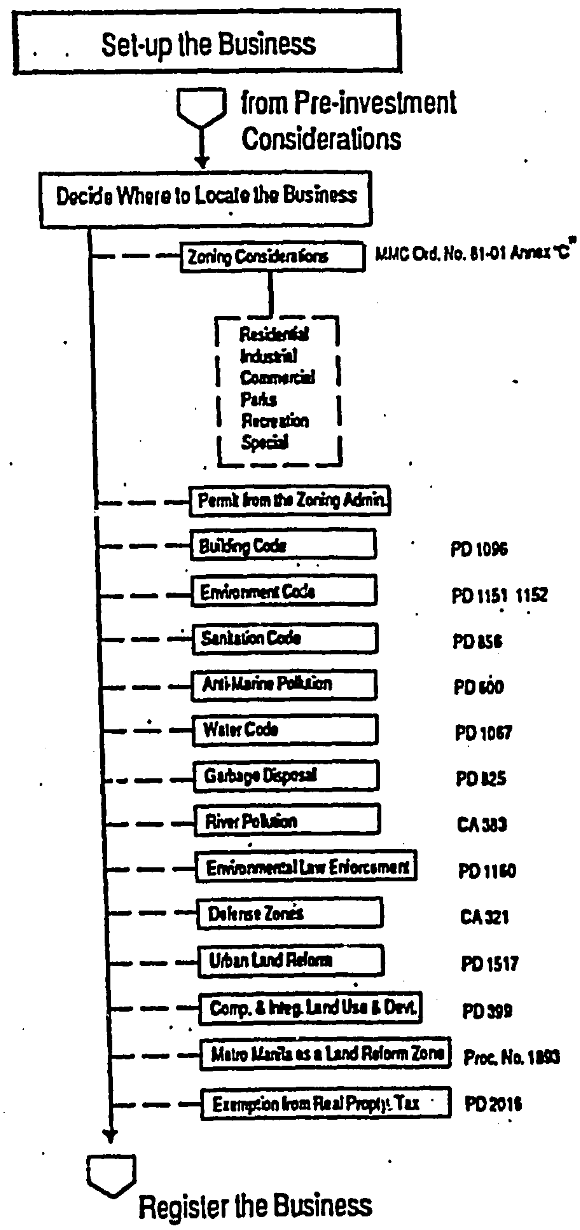


Figure 4.2 (continued)
Pre-Investment Considerations and Registration Procedures
for Small and Medium Enterprises

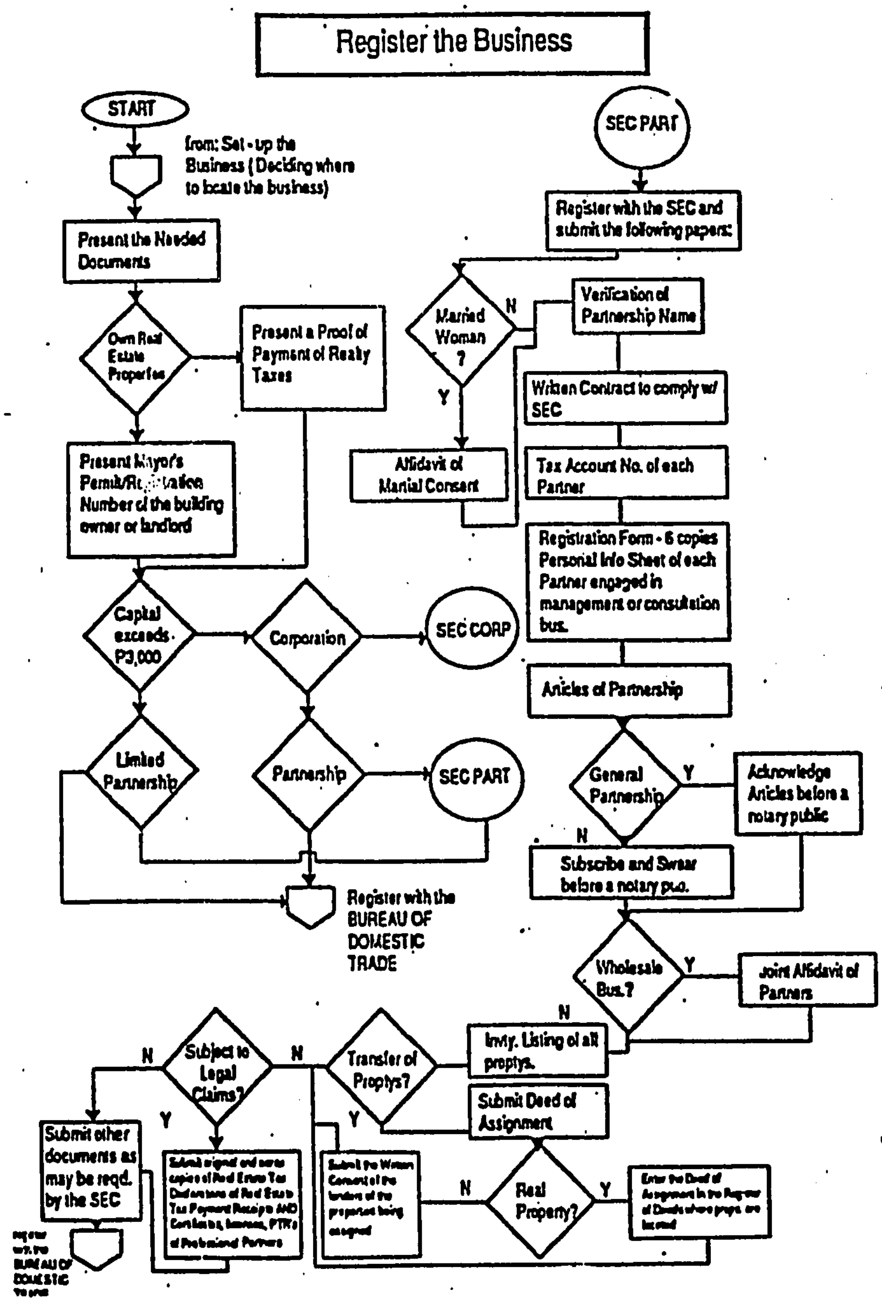


Figure 4.2 (continued)
Pre-Investment Considerations and Registration Procedures
for Small and Medium Enterprises

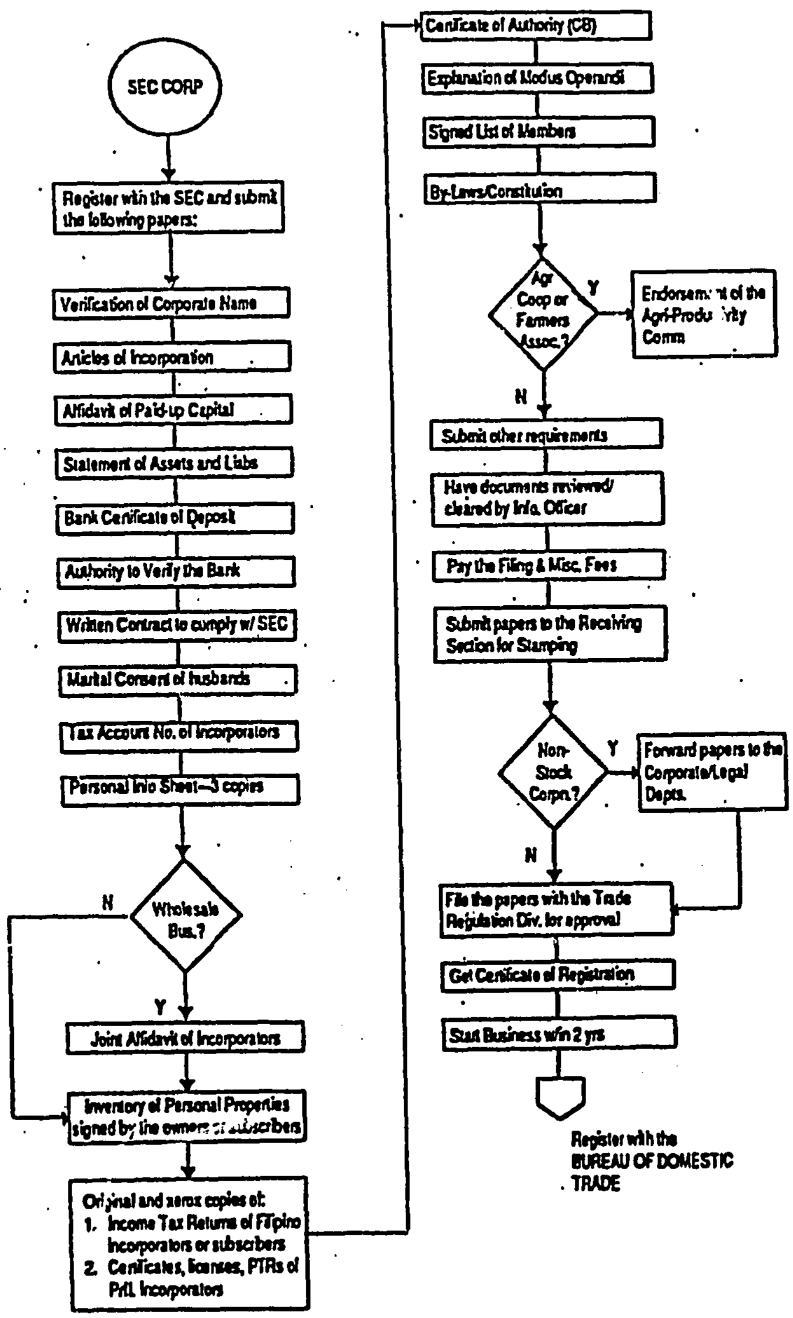


Figure 4.2 (continued)
Pre-Investment Considerations and Registration Procedures
for Small and Medium Enterprises

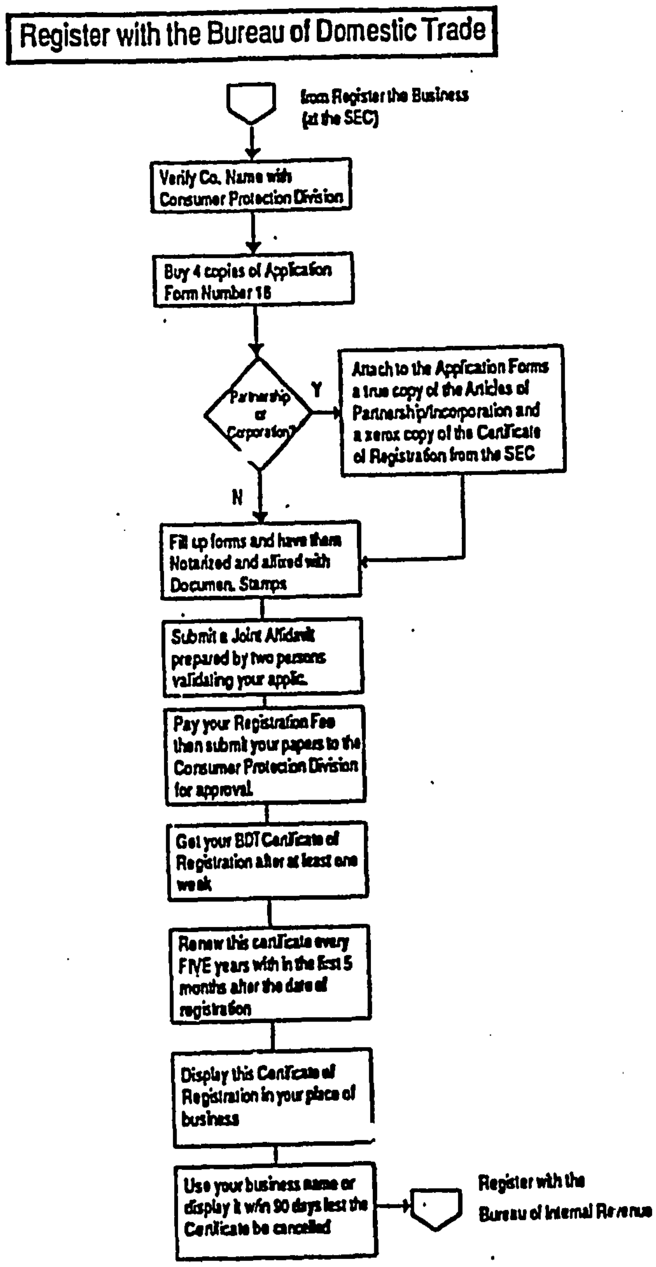


Figure 4.2 (continued)
Pre-Investment Considerations and Registration Procedures
for Small and Medium Enterprises

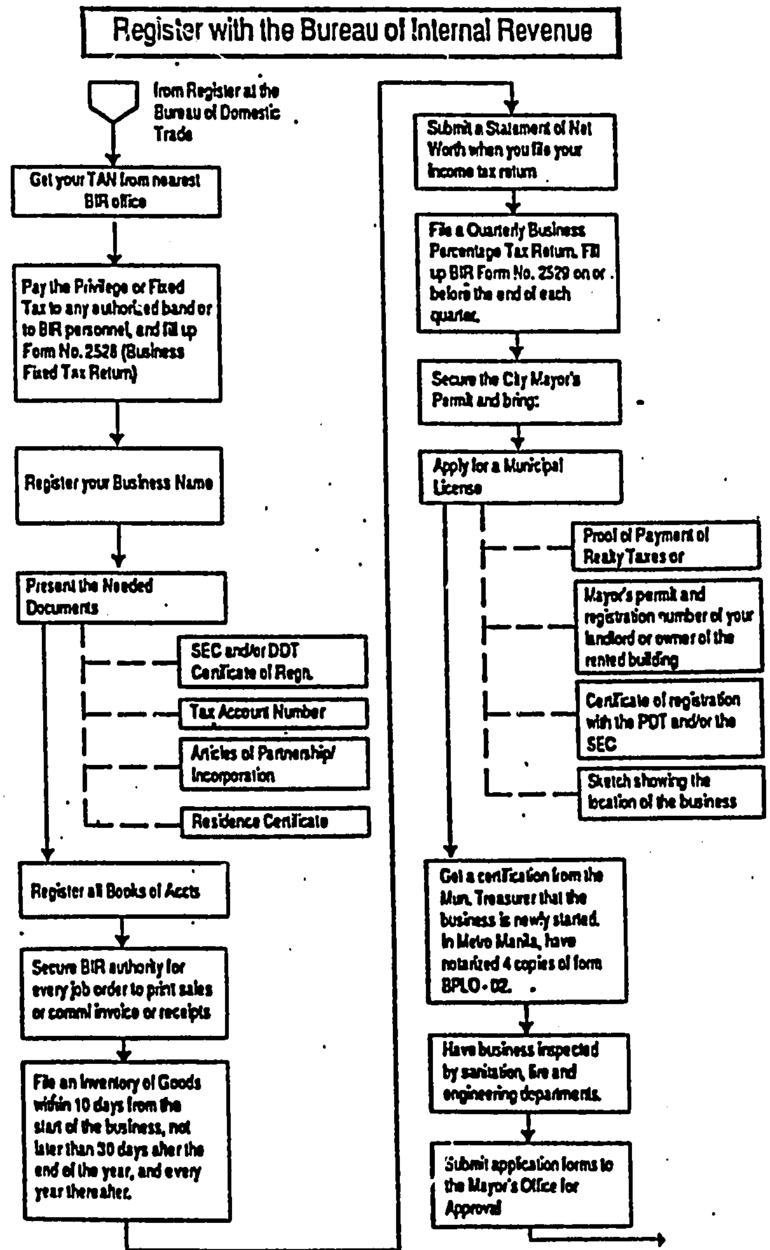


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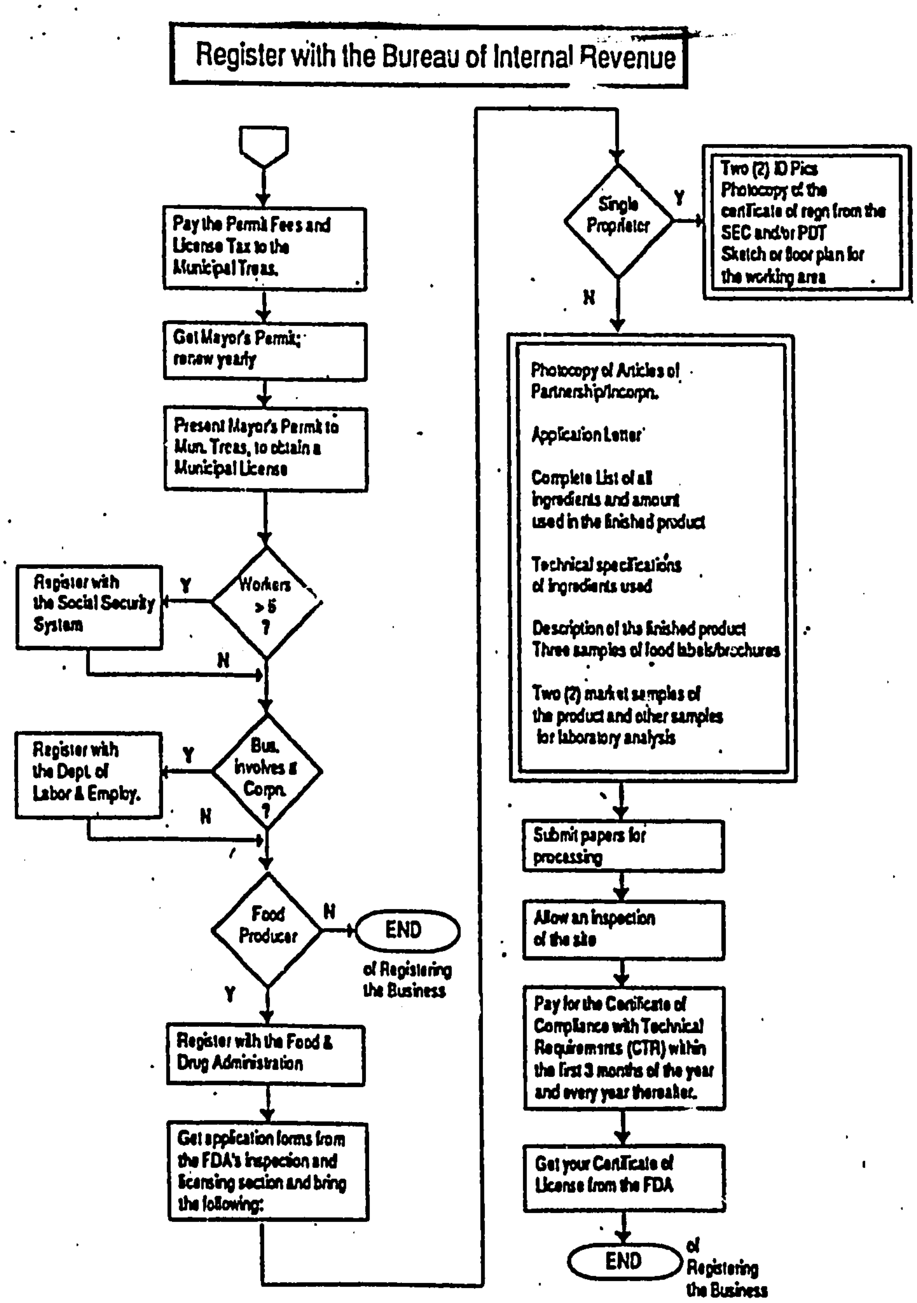
Figure 4.2 (continued)
Pre-Investment Considerations and Registration Procedures
for Small and Medium Enterprises



Unclear or cumbersome implementing rules, reversible bidding procedures, and similar bureaucratic arrangements can deter entry. There have been several instances where losing bidders go to court and block award of bids.

Many reforms which contribute to improved entry conditions often run afoul of bureaucratic hurdles. For instance, the Build-Operate-Transfer (BOT) Law (RA 6957) has run against various snags. BOT proponents must have their proposed projects included in the list of medium-term infrastructure programs. National projects requires approval by national government agencies for approval, and local projects by local development councils. Consequently, the approval of BOT project often can take more than a year. This is on top of the 3 to 4 years required for preoperating activities. The Congress has remedied the situation by designating the Investment Coordinating Committee (ICC) of the National Economic and Development Authority (NEDA) as the approving body with a mandatory 60-day period to hand down its decisions. To its credit, NEDA is presently making necessary changes in the BOT law itself and implementing rules to render the scheme more operational and acceptable to potential investors.

Laws as Exit Barriers

Some laws can prevent exit and thereby act as entry barriers because they restrict transfer of resources from one industry to another, or their transformation from one form to another (e.g.from capital investment to portfolio investment).

Laws on Insolvency and bankruptcy

In this instance, protracted bankruptcy procedures can serve to discourage potential entrants. The Insolvency Law (Act No. 1956 as amended), the main law dealing with insolvency, seeks to effect an equitable distribution of the insolvent's property among his creditors, to benefit the debtor in discharging him from his liabilities and enabling him to start afresh with the property set apart for him as exempt.

This law deals with suspension of payments, insolvency and discharge. It provides that a debtor (whether an individual, partnership or corporation) who possesses sufficient property to cover his debts but wishes to delay or suspend payments thereof as they fall due so as to gain time to pay all his debts without impairing his business, may apply for a court order suspending payment of such debts.

An insolvent debtor, on the other hand, may be discharged from debts after appropriate proceedings to declare said debtor insolvent, and all properties and assets, except those which are exempt, have been distributed to creditors. Once a petition for discharge has been filed in court, all pending executions shall be suspended except those against properties especially mortgaged. In addition, an ordinary creditor may not file an action in court and no payments may be made, except in the ordinary course of business.

The Civil Code lays down the order of preference among claims with respect to specific movable property, as to the specific immovable property, and as to real rights and other properties of the debtor.

Every private corporation organized under the Corporation Code (except for banks and other financial institutions) may be dissolved either voluntarily or involuntarily. In case the dissolution affects the rights of any creditor having a claim against the corporation, a hearing before the Securities and Exchange Commission (SEC) is required. In the judgment dissolving the corporation, the SEC may appoint a receiver to take charge of the liquidation of the corporation, which refers to the winding up of its affairs, during a three-year period following its dissolution. When the corporation is insolvent, its creditors are entitled to have its assets distributed among them according to their respective rights and priorities.

Given the complex procedures, uncompetitive firms may opt to stay put, rather than to exit. During the Marcos regime, the way out for bankrupt crony firms is simply for government banks to bail them out.

Financial institutions also follow time-consuming bankruptcy procedures. In accordance with the Central Bank Act, whenever the Monetary Board finds that a bank or a non-bank financial intermediary is in a state of continuing inability or unwillingness to maintain a condition of solvency and liquidity deemed adequate to protect the interest of depositors and creditors, it may appoint a **conservator** who shall take charge of the assets and liabilities of the bank or non-bank as well as assume its management.

If the continuance in business of the banking institution would involve probable loss to its depositors and creditors, the Monetary Board designates a **receiver**, to immediately take charge of its assets and liabilities, collect and gather all assets and administer the same to the benefit of its creditors.

The Board determines within 60 days whether the banking institution may be organized or rehabilitated, so that it may be permitted to resume business. However, if it is insolvent and cannot resume business, the Board may order its liquidation. A **liquidator** shall then take over the functions of the receiver and shall convert the bank's assets to money for the purpose of paying off its creditors.

The procedures, while seemingly clearcut, could be stalled by litigation, or even reversed by courts. The Supreme Court, for instance, ordered the reopening of Banco Filipino which had been closed by the Monetary Board.

Laws on labor

Stringent labor laws can also serve as a barrier to exit. The Labor Code, which is a compilation of all pertinent labor laws, is premised on the State policy of providing adequate protection to labor. It stipulates the minimum conditions of employment, includes provisions on labor relations, the formation of workers' organizations and unions, unfair labor practices on the part of both management and labor, and termination and retirement of workers. Among the legitimate grounds for the termination of an employee are: the installation of labor saving devices, redundancy, retrenchment to prevent losses or the closing or cessation of operations of the establishment or undertaking.

The Code also provides that in case of bankruptcy or liquidation of the employer's business, the unpaid wages and other monetary claims of the employees shall be given first preference and shall be paid in full before the claims of government and other creditors may be paid.

According to the Supreme Court, this provision of the Labor Code, because of its impact on the entire credit system, cannot be viewed in isolation, but rather must be interpreted in relation with the provisions of the Civil Code on the classification, concurrence and preference of credits, which are particularly applied in insolvency proceedings where the claims of all creditors may be adjudicated (*Republic vs. Peralta*, 150 SCRA 37).

In other words, the Insolvency Law, the Civil Code provisions on classification of credits and the provisions of the Labor Code must be harmonized. In this connection, a distinction should be made between a preference of credit and a lien. A preference applies only to claims which do not attach to specific properties whereas a lien creates a charge on a particular property. The right of first preference as regards unpaid wages recognized by the Labor Code does not constitute a lien on the property of the insolvent debtor in favor of workers. It is merely as preference of credit in their favor and a method adopted to determine and specify the order in which credits should be paid in the final distribution of the proceeds of the insolvent's assets (*Development Bank of the Philippines vs. NLRC*, 186 SCRA 840).

Finally, in case of doubt, all provisions of the Labor Code have to be construed in favor of labor. This somewhat restricts the flexibility of employers in downsizing or shutting down altogether. In this instance, labor laws can discourage exit and impede entry of new players.

Local Governments as Potential Entry-Deterrent

With the passage of the Local Government Code, decentralization is approaching reality. The Code gives Local Government Units (LGUs) sweeping powers on delivery of basic services, taxation, land classification, etc. to enable these to become "self-reliant" units.

The use of these powers can be double-edged; LGUs can ease or restrict the entry of enterprises in their given locality. On the one hand, LGU authority to grant tax exemptions, incentives or reliefs to entities engaged in "community growth-inducing industries" or to grant franchises, permits or licenses can be a tool to encourage enterprises to locate in their areas.

On the other hand, the franchising and permit-granting powers, as noted in an earlier discussion, can have exclusionary or anticompetitive effects. Other probable entry barriers are the provisions on licensing and zoning which the Local Government Code effectively transferred from the Housing and Land Use Regulatory Board (HLURB) to LGUs. In principle, an LGU can bar the entry of an enterprise in a given locality by refusing to grant a locational clearance or a permit. (This is what occurred to the McDonald's franchise in Makati during the time of the late Mayor Nemesio Yabut.) Alternatively, an LGU can force the exit of an enterprise as can be seen in the case of the Shell liquefied petroleum gas (LPG) refinery in Biñan, Laguna.

On the whole, however, considering that enterprises are a potential source of income for local governments, local officials generally should not pose serious problems for potential entrants.

The Courts as Entry Barriers: The Principle of Judicial Review

The courts themselves may serve to block entry or confer advantages to the incumbents. Under the doctrine of separation of powers, the legislative branch represented by Congress, enacts laws to be implemented by the executive branch, composed by the various administrative agencies. Ultimately, however, the Supreme Court resolves issues relative to the exercise of powers by all governmental instrumentalities. This is the principle of judicial review of administrative decisions. Courts may review decisions to determine the constitutionality or validity of any law, ordinance, executive order, or regulation promulgated; the jurisdiction of any administrative board, commission, or officer; any question of law; or questions of fact when necessary to determine either a constitutional or jurisdictional issue, the commission of abuse of authority and when the administrative fact-finding body is unduly restricted by an error of law.

This principle is illustrated in the cases filed by House Representative Enrique Garcia of Bataan against the BOI. In the first case (*Garcia vs. BOI*, 177 SCRA 374), the approval of the Luzon Petrochemical Corporation (LPC), which sought to transfer the site of its petrochemical complex from Bataan, the original site, to Batangas was assailed, on grounds that the BOI committed grave abuse of discretion in not following the proper procedures. The Supreme Court ordered the BOI to: (a) publish the amended application of the LPC; (b) allow Garcia to have access to its records on the original and amended applications for registration; and (c) set for hearing Garcia's opposition to the amended application.

After BOI complied with the above orders and sustained its earlier decision approving the transfer of the site of the proposed plant from Bataan to Batangas and the shift of feedstock for the plant from naptha only to naptha and/or liquefied petroleum gas (LPG), Representative Garcia again filed a petition to set aside the said decision (191 SCRA 288). The Supreme Court found that the BOI committed grave abuse of discretion in approving the site transfer and in authorizing the change of feedstock, for the main reason that "the final say is in the investor all other circumstances to the contrary notwithstanding. No cogent advantage to the government has been shown by this transfer. This is a repudiation of the independent policy of the government expressed in numerous laws and the Constitution to run its own affairs the way it deems best for the national interest." Hence the Court set aside as null and void the decision of the BOI approving the amendment of the certificate of registration of the LPC. This became moot and academic, however, considering the LPC decided to abandon the project (see also Box 6.1 on the LPC controversy).

PUBLIC POLICY ON FREE ENTERPRISE, MONOPOLIES AND FAIR TRADING

The foregoing discussion might give the wrong impression that the country is uncommitted to free enterprise, antitrust and fair trading. On the contrary, we have many statutes which prohibit unfair or restrictive practices.

Antitrust Legislation

The country's antitrust policy is embodied in several laws (Domingo 1985)[4], which separately or together prohibit: (a) any conspiracy or combination in the form of trust that affects free competition in the market, (b) monopoly in the trade of any commodity, (c) collusion in price fixing, (d) certain mergers or acquisitions, and (e) interlocking directorates.

The relevant laws are as follows:

Laws on monopolies and combinations

RA 3247, as amended, and Articles 185, 186, 188 and 189 of the Revised Penal Code are the basic statutes which prohibit unfair trade practices, monopolies and combinations in restraint of trade.

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[4] Domingo adopts the definition of Black's Law Dictionary of "antitrust" as referring to "statutes to protect trade and commerce from unlawful restraints, price discrimination, price-fixing and monopolies."

Section 4, paragraph 5 of RA 5455 likewise provides that the entry of foreign investors in the country should not pose a clear and present danger of promoting monopolies or combinations in restraint of trade. Section 7 (g) of RA 6173 further provides that adequate steps shall be taken to prevent monopolies and combinations in restraint of trade within the petroleum industry.

In summary, laws exist which should deter any person, firm or entity from monopolizing or attempting to monopolize, or from taking part in any conspiracy of combination in the form of trust in restraint of trade or commerce or from restraining free competition in the markets (Article 186, Revised Penal Code, 1932).

The prohibition includes trust, pool, or other association of persons,whether natural or juridical, primarily designed for, among others, monopolizing or trafficking in a particular commodity, stifling or excluding competition or interfering with the normal course of business.

In penalizing monopolies and combinations in restraint of trade, the legal theory is that trade should be shielded from such practices to promote efficiency and competition thereby effecting increased output, economic growth and the lowering of prices.

Laws on patents and trademarks

There are also laws protecting patents and trademarks. The Patent Law (RA 165, as amended) provides that any invention of a new and useful machine, manufactured product or substance, process or an improvement of any of the foregoing, is patentable.

The patent application may be filed by the inventor, his heirs, legal representatives of assigns. A patentee has the exclusive right to make, use, and sell the patented machine, article or product and to use the patented process for the manufacture of the industry or commerce throughout the territory of the Philippines for the term of the patent; and such making, using or selling by any person without the authorization of the patentee constitutes infringement of the patent.

The patent-holder whose rights have been infringed may bring a civil action in the proper court to recover from the infringer damages sustained by reason of the infringement and to secure an injunction. In case of repeated infringement, the parties liable are subject to criminal penalties.

A trademark or tradename duly registered in the proper government bureau or office is owned by and pertains to the person, corporation or firm registering the name, as provided for under Article 520 of the New Civil Code.

In addition, Section 2 of the Trademark Law (RA 166) provides that trademarks, and service marks owned by persons, corporations, partnerships or associations domiciled in the Philippines and in any foreign country may be registered, provided that said trademarks, tradenames or service marks are in actual use in commerce and service not less than two months in the Philippines before the time the applications for registration are filed and provided that the country of which the applicant for registration is a citizen grants by law substantially similar privileges to citizens of the Philippines.

Any person entitled to the exclusive use of a registered mark or tradename may recover damages in a civil action from any person who infringes his rights. He may also be granted an injunction.

In addition to civil remedies, the guilty party may also be criminally prosecuted under the provisions of Article 188 and/ or Article 189 of the Revised Penal Code and subjected to a penalty consisting or imprisonment or fine.

To digress somewhat, patents and trademark laws are undoubtedly barriers to entry, serving effectively to promote officially sanctioned monopolies during the life of the patent or trademark. Having said this, however, it is difficult to generalize regarding the welfare significance of recognizing such patents, for on the other hand, there are equally compelling arguments for the recognition of patents as one of the few means for innovators to internalize the returns from their innovations -- on the assumption that the supply of innovations depends on such returns. A consideration of national versus international perspectives must also be brought in, in light of the fact that the bulk of patents held in the country are held by foreigners and not by Filipinos. It is a crucial question to what extent such patents are actually utilized (in which case the country benefits at least from the products resulting although the processes may be owned by foreigners) or are simply held as "sleeping patents" to deter entry. For this purpose, detailed studies of particular industries would have to be conducted to the extent patents and trademarks, especially the former, are necessary.

Laws on unfair competition, mislabeling and fraudulent advertising

The operative law on these matters is also RA 166. Chapter VI of the Act specifies that a person who has identified in the mind of the public the goods he manufactures or deals in, his business, or services, from those of others whether or not a mark or tradename is employed, has a proprietary right in the goodwill of the said goods, business or services so identified.

These are protected in the same manner as other proprietary rights such that any person who employs deception or any other means contrary to good faith by which he passes off the goods manufactured by him or in which he deals, or his business or services for those of the one having established the goodwill, or who commits any acts calculated to produce said result, shall be guilty of unfair competition, held liable for damages and subject to injunctions. Furthermore, he may be criminally prosecuted under the Revised Penal Code and punished by fine or imprisonment.

In addition, Article 26 of the Civil Code entitles a person who suffers damage as a result of or from unfair competition in agricultural, commercial or industrial enterprises , to compensation in the form of damages.

With respect to mislabeling, Chapter VI of RA 166 prohibits any person, firm or corporation, either as principal or agent, to display, sell, barter or exchange, or to cause to be sent, carried or brought for display, sale, barter or exchange from any foreign country into the Philippines, or from the Philippines into any foreign country, any article which is falsely packed, labeled or marked, in such a way as to misrepresent the character, amount, value, contents, properties or condition of the article or of the materials of which is composed, or any article which is accompanied by advertising matter which misrepresents the character, amount, value, contents, properties or condition of the article advertised or of the materials of which it is composed whether or not the article or the container thereof, is mislabeled or misrepresented.

Furthermore, RA 166 also prohibits any person, firm or corporation, either as principal or as agent, to advertise in any newspaper, book or periodical printed in the Philippines, or in any handbill, billboard, pamphlet, circular or other form of advertising, any article when its character, value, properties or condition is misrepresented.

Moreover, persons, firms or corporations are prohibited from misrepresenting the character or value of any stocks, bonds, and shares, or of the properties or prospectus of any firm or corporation. Finally, it is unlawful for any person or corporation to use the mails of the Philippines for the circulation of any advertising matter which is not allowed by law.

Law on combinations, mergers and consolidations

Combinations, mergers and consolidations are governed by the Corporations Code, enacted through BP 68[5]. The Code provides for the formation and organization of corporations, defines their powers, fixes the duties of directors and officers, declares the rights and liabilities of stockholders and prescribes the conditions under which they can transact business.

The Code recognizes different modes of corporate reorganizations and combinations, the most common of which are: holding companies, mergers and consolidations.

- A holding company is one that controls the capital stock of another corporation or of several corporations which become its subsidiaries. The controlled corporations may be either wholly- owned or majority-owned subsidiaries of the holding company.

- A merger is a form of corporate combination whereby one corporation is absorbed by another corporation resulting in the loss of legal personality and dissolution of the absorbed corporation. The absorbing corporation survives and continues the combined business. This is effected through the exchange or sale of all or substantially all of the assets of one corporation for the shares of another corporation, which becomes the absorbing corporation.

[5] Three general forms of business organizations are recognized in the Philippines -- the single proprietorship, the partnership, and the corporation. Sole proprietorships and partnerships are generally governed by the Civil Code of the Philippines and by the special laws relating thereto. On the other hand, the rules dealing with, or relating to, corporations can be classified into two groups, namely: the Corporation Code and related statutes; and the Revised Securities Act and related laws.

- In the case of consolidation, two existing corporations combine to form a third corporation. After the combination, the two original corporations are dissolved because they cease to have a reason for their separate existence.

With the combination, merger, consolidation or holding company, the market position of the entities concerned is changed. They either become more competitive in the business sector in which they are engaged, monopolize the trade, or minimize competition among the companies engaged in the same line of business.

The following cases illustrate the foregoing:

- the merger in September 1989 of two companies engaged in the electronics business with substantial Japanese interests gave the merged entity a better chance of improving its competitiveness in its industry sector where other companies with Japanese and Korean investments were likewise very active;

- the merger of two mining corporations in October 1989 expanded their business activities;

- the merger of a corporation engaged in yarn and four other textile firms in August 1990, to improve their market standing in the oligopolistic textile business; and

- the rumored buyout of a majority interest (owned by foreign firms) in a domestic firm with a mobile phone franchise by the president of a leading telephone firm.

Under the Corporation Code, any stockholder of more than one corporation organized for the purpose of engaging in agriculture may hold his stock in such corporations solely for investment and not for the purpose of bringing about or attempting to bring about a combination to exercise control of such corporations.

In the case of *J. Gokongwei, Jr. vs. Securities and Exchange Commission (SEC)*, 89 SCRA 336, the Supreme Court ruled that considering both Robina and San Miguel Corporation (SMC) are, to a certain extent, engaged in agriculture, the election of Gokongwei, Jr. to the Board of SMC may constitute a violation of said provision of the code. In addition, the Court also ruled that a director stands in a fiduciary relation to the competition and its stockholders and that the disqualification of a competition from being elected to the board of directors is a reasonable exercise of corporate authority, pursuant to the provision that a corporation is authorized to prescribe the qualification of its directors. Hence, interlocking directorships of corporations are regulated.

The Civil Code also provides that contracts between two corporations having interlocking directors is valid, as long as the contract is fair and reasonable, not fraudulent, and where the director has substantial interest (more than 20 percent of outstanding capital stock) in one corporation and minimal in the other, the following conditions must be present:

- the presence of such director in the board meeting approving the contract is not necessary to constitute a quorum,

- the vote of such director is not necessary to approve the contract,

- in case the above conditions are not present, a contract with the director may be ratified by 2/3 vote of the outstanding capital stock in a meeting called for the purpose and full disclosure of the adverse interest of the director shall be made in the meeting.

In instances where a director, through his office, acquires for himself a business opportunity which should belong to the corporation, he must refund all the profits acquired by him, unless his act has been ratified by a 2/3 vote of the outstanding capital stock. The restriction applies even if the director risked his own funds. The same case of *J. Gokongwei, Jr. vs. SEC* exemplifies this corporate opportunity doctrine where the Supreme Court held:

> "It is obviously to prevent the creation of an opportunity for an officer or director of San Miguel Corporation, who is also the officer to a competing corporation, from taking advantage of the information which he acquires as a director to promote his individual or corporate interests to the prejudice of San Miguel Corporation and its stockholders, that the questioned amendment was made. Certainly, where two corporations are competitive in a substantial sense, it would seem improbable, if not impossible, for the director, if he were to discharge effectively his duty, to satisfy his loyalty to both corporations and place the performance of his corporation duties above his personal concerns".

With respect to banking corporations, it is the General Banking Act and the Central Bank Act which applies; the Corporation Code is merely suppletory. These laws provide for the restrictions on corporate stockholdings.

Law on Issuance of stocks and other securities

Related to the above laws is the Revised Securities Act which governs the sale, offering for sale and distribution of securities. The term "securities" includes stocks and bonds, commercial papers, pre-need plans and commodity futures contracts. The law provides for the submission of meaningful set of data necessary for intelligent investment decision-making and imposes the duty of complying with reportorial requirements in cases of tender offers, proxy solicitations, and other related transactions, in order to protect the interest of the minority stockholders.

The number of publicly held corporations is insignificant when compared to the number of registered corporations. This may be attributed to a number of reasons. First, some corporations are closely held family enterprises with little need to finance their activities beyond the financial capabilities of the families concerned. Moreover, they fear losing control over their enterprise. Second, some corporations view the government as not granting enough fiscal or non-fiscal incentives for them to go public; and, third, some would-be registrants consider the registration process under the Act as being too cumbersome.

Consumer Code of 1992

Ratified by the House of Congress in the last session is the bicameral conference committee report which reconciled HB 33757 and SB 1820. This is the so-called "Consumer Code of 1992" which aims to afford greater protection and benefits to the consumers. It consolidates various consumer laws contained in the country's statute books and mandates the education of consumers. A decentralized National Consumer Affairs Council will rationalize and coordinate the functions of the agencies charged with consumer programs and enforcement of consumer related laws, make policy recommendations and monitor and evaluate the implementation of consumer programs and projects, and undertake a continuing education and information campaign for consumers.

The Act provides for a simple and non-technical enforcement mechanism as an alternative to court action. Consumer Arbitration Officers will be tasked to effect settlements between parties in a consumer complaint and, in the event of failure to reach a settlement, adjudicating the matter before him.

Ineffectiveness of Existing Antitrust Laws

As may be gleaned from the preceding discussion, the country has many statutes which prohibit unfair practices, collusion and related barriers to entry, in accordance with the policy of the state to promote competition and prevent monopolies. However, three observations can be made of the present antitrust laws that serve to make them virtually ineffective.

Noncodification of the law

Antitrust provisions have not been compiled and collated into a comprehensive antitrust legislation. Furthermore, the acts which are prohibited and considered illegal are too broad, general, and not very specific.

Lack of jurisprudence

Under the Sherman Act of the United States, price-fixing, market division and boycott agreements among competitors are generally considered as "per se" violations. They are therefore easier to detect, prosecute and prevent than monopolization, which is subject to the "rule of reason".

Under the "per se" approach, the American courts have found certain practices to be so inherently anticompetitive that they are held to be illegal restraints of trade without analysis of their competitive effects in a particular case. Under the "rule of reason" approach, on the other hand, particular practices are analyzed in detail and are held illegal only if it can be shown, based on the facts of the individual case, that the anticompetitive effects outweigh any competitive benefits resulting from the challenged conduct.

Very few cases have been adjudicated by the Philippine Courts on monopolies and unfair competition, despite the presence of legislation. This could possibly be attributed to the cases having been settled amicably in the lower courts or that aggrieved parties are not too interested in pursuing cases. To begin with, the quantum of evidence required so that the case may prosper - proof beyond reasonable doubt - is difficult to obtain. In addition, the witnesses and/ or aggrieved parties, because of the long tedious legal processes involved, are not themselves interested in putting the perpetrators behind bars; rather they are more interested in an injunction, for violators to cease and desist from engaging in their unlawful activities. Lastly, the imposable fines are not very stiff and, consequently, do not provide sufficient deterrent to would-be criminals.

To date, only two cases have been decided by the Supreme Court on violations of Article 186 of the Revised Penal Code. However, there have been more cases regarding violations of Article 188 on the fraudulent use of trademarks and tradenames (see **Box** 3.1). The majority of cases have been civil and administrative cases on infringement of patents and trademarks.

Again, although RA 3518, Section 20 is very similar to Section 7 of the Clayton Act of the United States, as amended, in that corporate mergers may be prohibited when their effect may be substantially to lessen competition, or to tend to create monopoly, this was not construed by Philippine courts. A reason could be the absence of implementing guidelines, contrary to that in the United States where parties contemplating a merger have to comply with the Department of Justice guidelines (14 June 1984).

The Supreme Court, in the same case of *J. Gokongwei, Jr. vs. SEC* recognized that the law against monopolies and combinations in restraint of trade is aimed at contracts and combinations that, by reason of the inherent nature of the contemplated acts, prejudice the public interest by unduly restraining competition or unduly obstructing the course of trade (*Filipinas Compania de Seguros vs. Mandanas*, 17 SCRA 391).

In the same case, the High Court also adopted the definition of monopoly as applied by other jurisdictions, in the absence of a definition provided by law. Hence, the Court, quoting American cases, said that

> "... a monopoly embraces any combination the tendency of which is to prevent competition in the broad and general sense, or to control prices to the detriment of the public. In short, it is the concentration of business in the hands of a few. The material consideration in determining its existence is not that prices are raised and competition actually excluded, but that power exists to raise prices or exclude competition when desired. Further, it must be considered that the idea of monopoly is now understood to include a condition produced by the mere act of individuals. Its dominant thought is the notion of exclusiveness of unity, or the suppression of competition by the unification of interest of management, or it may be through agreement or concert of action. It is, in brief, unified tactics with regard to prices".

It is unfortunate however, that because of the very few cases decided by the Supreme Court on the matter, Philippine courts have not been able to evolve either a "per se" rule or a "rule of reason" as the case may be, on activities and practices involving monopolies and unfair competition.

Diffused responsibilities in implementation

While specific implementing rules and regulations of the different antitrust and unfair competition laws are scattered under various categories, several government agencies appear to have been mandated to implement related laws. Precisely because of this diffused responsibility, implementation of antitrust and related laws has not been effective.

It suffices to say that many are of the perception that monopolies, unfair competition, undue restraint of trade and other restrictive business practices do exist and are just benignly ignored or tolerated. This therefore points to the need for a central machinery to investigate and ascertain the existence of monopolies, malpractices and undue restraint of trade, and impose sanctions whenever necessary.

A related problem is the lack of public awareness on what competition entails. As a result, collusion and price-fixing among firms, the proliferation of cartels and other restrictive business practices have become entrenched in the country and difficult to break. Those affected at times do not even realize what is going on. Hence, what is needed is the development of a strong consumer movement or the full operationalization of the Consumer Code.

BOX 4.1: ILLUSTRATIVE CASES/JURISPRUDENCE

Article 185, Revised Penal Code

In the case of *Diaz vs. Kapunan* (45 Phil. 482), the Supreme Court, in its 1923 decision, ruled that the courts will consider an agreement between a judgment creditor and one claiming an interest in the thing about to be sold under an execution sale, that neither shall bid against the other, as void, unless all parties concerned know of the arrangement and consent thereto. This is because public policy discountenances combinations or agreements on the part of bidders at execution sales, the objects and effects of which are to stifle competition. The law punishes any person who shall solicit any gift or promise as a considering for agreeing to refrain from taking part in any public auction. The crime is consummated by the mere act of soliciting a gift or promise for the purpose of abstaining from taking part in the auction.

Article 186, Revised Penal Code

In the 1905 case of *US vs. Fulgueras*, the Supreme Court ruled that the fact that defendant attributed to himself a supernatural power and pretending to hold a commission from a powerful chief, went about distributing papers and proclamations to the people of a certain town, spreading subversive and fanatical ideas, and with orders from his alleged chief to lower the prices of needful commodities and to reform the customs under the penalty of being visited by flood and other calamities, and through these machinations and deceit, succeeded in deceiving ignorant people and caused them to provide themselves with instruments of measure larger than they formerly had and different from the regular size and also succeeded in making them lower the price of commodities, constitutes the crime punishable under said provision.

Article 188, Revised Penal Code

In the case of *US vs. Kyburg (1914)*, the Court ruled that the defendant, who imported similar watches from the same manufacturer as the private complainant and advertised and sold them under the name of, and as and for Meridian watches is guilty of violation of the provision prohibiting and penalizing unauthorized use of the tradename of another. The Court said that the law protects manufacturers or dealers as well as the public, from unfair competition by the use of trade names upon the principle that no person has the right to sell his own goods as those of another.

Review of Failed Bills

In the same manner, the country's legislators are perceived as not mindful or appreciative of the need to enact a comprehensive antitrust legislation at the present time. This seems to be a widespread perception, notwithstanding the fact that there are several pending bills that seek to tighten rules on monopolies and unfair competition. These bills, along with those bills on patents and other competition-fostering measures, were left pending before bicameral committees at the final close of Congress. This effectively "killed" (placed in archives) all of these bills. At best they may be revived and refiled once the new Congress is installed. A review of these failed bills is still instructive, however, to the extent similar ones are likely to be filed:

Bills on monopolies and unfair competition

There were three proposed bills pending in the House of Representatives and one in the Senate which sought to establish a more comprehensive law for the purpose of protecting trade and commerce against unlawful restraints and monopolies. These bills were very similar to Parliamentary Bill No. 989 introduced almost a decade ago.[6]

- The first proposal, HB 23560, titled "An Act Against Unlawful Restraints and Monopolies on Commerce" sought to expand the coverage of the antitrust law to cover any line of trade or commerce, as well as any commodity, for use and/or consumption including entering into tying contracts.

  The bill likewise sought to create special bodies to exercise powers of regulation, namely, the Land Transportation Office in cases of common carriers; the Central Bank, in Banking; and the Bureau of Domestic Trade in all other types of commerce. It likewise seeks to increase the fine for violation of the law.

- The second was HB 26240 titled, "An Act Creating a Special Body that Shall Regulate and Exercise Authority Over Monopolistic Practices, Combinations in Restraint of Trade or Unfair Competition and Appropriating Funds Therefor",

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6 During the late 1970s, Parliamentary Bill No. 989 titled "The Antitrust Law of the Philippines" was introduced in the Interim Batasang Pambansa (IBP). It sought to prohibit and penalize all contracts, agreements or conspiracies which would unreasonably restrain trade or commerce such as price-fixing, market divisions, group boycotts, etc.. It also sought to prevent monopolization or attempts to monopolize and the unjustified discriminatory practice (usually resorted to and availed of by those who are dominant in a particular market) of unscrupulous persons in entering into contracts with different persons similarly situated but under different contractual conditions. The undue concentration of economic power in one single corporation as well as through interlocking directorates was sought to be avoided, and consumer protection to be promoted. The proposed bill applied to all natural or juridical persons engaged in commerce as well as to both domestic and foreign corporations where their conduct had substantial effect on Philippine trade and commerce. Violations, even if committed outside Philippine territory were within the jurisdiction of Philippine courts, in effect providing an extraterritorial reach. Lastly, it sought to impose civil liability on violators. Although the bill contained very good provisions, it was never even discussed by the IBP.

proposed the creation of an agency to be known as the "Philippine Antitrust Commission" that would have enforce the provisions of the antitrust laws.

The Commission would be granted visitorial, investigative and coercive powers, in order to enforce effectively the antitrust law. It likewise aimed at lengthening the period of incarceration and increasing the fines of those found guilty of a violation.

- The third bill was HB 26308, "An Act Implementing Section, 19, Article XII of the 1987 Constitution: Defining and Prohibiting Monopolies and Combinations in Restraint of Trade, Providing Penalties for Violations Thereof, and for Other Purposes".

  It proposed the creation of the Office of the Anti-Trust Prosecutor which would be empowered to: enforce and administer antitrust laws, investigate and prosecute violations thereof, initiate and prosecute the appropriate civil action, make a civil investigative demand, compel a prospective civil defendant to produce documents, require persons engaged in trade, commerce or industry to file reports, investigate trade conditions; investigate and make recommendations for the readjustment of business; initiate and prosecute the proper action or proceeding to restore natural, unrestricted or full competition; initiate and prosecute the proper action or proceeding to dismantle all combination of capital; and initiate criminal action and prosecute offenders.

- Senate Bill (SB) No. 996 "An Act to Re-Examine, Realign and Recast into the Requirements of the Constitution the Laws Prohibiting Monopolies, Combinations in Restraint of Trade and Unfair Competition and for Other Purposes" was designed to restore competition where it had disappeared, preserve it where it prevails, and perpetuate it as a system for controlling and regulating the Philippine economy.

  Like HB 26240, it contained a proposal to establish an independent, special antitrust commission to oversee the enforcement of the Act once it has been made law. In effect, the bill sought to create a Philippine Ombudsman on Trade, Commerce and Industry with visitorial, investigative and coercive powers similar to the powers granted to the Antitrust Prosecutor under HB 26308.

Taken together, all the proposals were brought about by a need to recast the present laws of monopolies and combinations in restraint of trade. A review of the substantive provisions of the bills in terms of their scope and coverage shows that what was proposed is an unconditional prohibition of all contracts and conspiracies in restraint of trade, taking on the character of the Sherman Act and the Clayton Act. By their nature, the proposed legislation would subsume certain economic costs involved in the breaking up of illegal activities which restrain trade (such as enhanced ability to undertake Research and Development) to the higher objective of maintaining competition.

Bills on patents

Several bills were filed in the Senate seeking amendments to the Patents Act.

- SB 653 provided that no patent should be issued on an application for an invention which has been banned abroad or for an invention covered by foreign patent which has already expired. In addition, a patent already issued may be canceled if the patent is over an invention which has been banned abroad or for an invention covered by a foreign patent which has already expired.

- SB 703 sought to abolish and prohibit patents for inventions related to drugs and medicines, pharmaceutical preparations and products, vitamins and nutritional supplements, and other products similarly essential to the maintenance of life and the improvement of health.

- SB 770 likewise sought the abolition of patents on medicines and limits the payment of royalties to one percent of the net profit on sales. It also provides that Filipino citizens or corporations with at least 60 percent of its stock owned by Filipinos may manufacture or produce any drugs or patents owned and registered by foreigners in the Bureau of Patents, Trademarks and Technology Transfer without the consent of the owner of the patent or its assignee. (Relatedly, SB 509 seeks to limit the right to engage in the drug industry to citizens of the Philippines and to corporations at least 60 percent of the capital stock of which are owned by citizens of the Philippines).

- SB 841 aimed to break the monopoly situation in the drug industry where patent holders have singular control of the market for 17 years. Hence, the bill provides that no patent shall be granted for single compound drugs and an interim licensing mechanism that will allow a compulsory license applicant to go ahead with his intent even if his application for compulsory license is still pending. The bill also fixes the total royalty payments of licenses, whether compulsory or interim, at 2.5 percent of net wholesale price.

All of the abovementioned bills sought to increase competition, thereby reducing the cost of medicines, ensure their affordability to Filipinos and encourage the development of a drug industry which will serve the national welfare and interest.

Meanwhile, HB 24489 sought to broaden the coverage of patentable inventions to keep pace with modern technological trends. More specifically, it proposed to include as patentable "new strains of micro-organisms or of any other living matter produced with the intervention of human ingenuity". Without this, investors in economically advanced countries will not be willing to share with the Philippines the fruits of their R&D.

A clear intellectual property rights system that rewards creativity and ingenuity to spur economic development is important to any country. Patents are one of the major instruments that protect intellectual property rights. The patenting law is therefore a very delicate matter. It must achieve a balance between promoting technological development and competition.

Admittedly, the Philippines is technologically lagging behind developed and newly industrializing countries. Restrictive patent laws deter entry by foreign investors who are willing to bring along with them new inventions or processes. Some of these inventions or processes may be used to improve efficiency of existing industries. Others will be used to produce products that are close substitutes to those inefficiently produced by highly concentrated industries, thereby improving competition.

Other competition-fostering bills

Finally, there were other bills designed to foster competition or to improve the investment climate:

- HB 30521 aimed to liberalize the entry of investments by multilateral financial institutions and ASEAN nationals as domestic equity, effectively suspending the nationality requirement of the Omnibus Investments Code and any other laws in this regard.

- HB 30522 proposed to universalize the availment of incentives by all BOI-registered firms. Instead of tax holidays, it will grant net operating loss carryover (NOLCO) and accelerated depreciation deductions for income tax purposes. It will also exempt selected capital equipment imports from all forms of duties for a period of five years. This will somewhat lessen the discretionary powers of the BOI and, to a certain extent, reduce the potential fiscal burden.

- HB 35068 sought to allow foreign banks to set up branches or wholly-owned subsidiaries in the country.

V INSTITUTIONAL AND ADMINISTRATIVE ARRANGEMENTS: FOCUS ON THE BOARD OF INVESTMENTS

OVERVIEW OF ADMINISTRATIVE ARRANGEMENTS

The rise of Big Government in the economically advanced countries since the Great Depression of the 1930s has its counterpart in the interventionist state that came to power in many of the less- developed countries.

In the Philippines, the era of expanding government, which spans the period from roughly the postwar reconstruction of the late 1940s and early 1950s down to the late 1970s and early 1980s, spawned many government agencies engaged in promoting and regulating almost all aspects of the economy and society. This is nowhere more clearly seen than in the organization and operation of many state enterprises (numbering more than 300 in the mid1980s), but it is also evident in the proliferation of planning, fiscal and financial agencies, coordinating bodies for almost every conceivable activity, and regulatory bodies.

Proliferation of Regulatory Agencies

Government intervenes in markets in response to certain private interests or normative objectives (e.g. to promote competition and to regulate monopolies). In the Philippines, a number of institutional and administrative arrangements have been evolved with the goal of maximizing efficiency and ensuring public welfare, in other words, to foster an efficient market outcome. Among these arrangements are the SEC, the CB, the BOI, the HLURB the National Telecommunications Commission (NTC), the Civil Aeronautics Board (CAB), the Land Transportation Franchising and Regulatory Board (LTFRB), the MARINA, the Philippine Ports Authority (PPA), the Insurance Commission, the Sugar Regulatory Administration (SRA), the Philippine Coconut Authority (PCA), the Garments and Textile Exports Board (GTEB), and the Energy Regulatory Board (ERB).

The SEC is an independent commission charged with the implementation of the Corporation Code and the Revised Securities Act. Included in the former are provisions on mergers, consolidations, monopoly and other "restraints on trade". SEC is also tasked with the registration of all forms of enterprises, profit as well as nonprofit, and in regulating the stock and other exchanges.

The CB regulates and supervises the banking system and exercises regulatory powers over the operations of nonbank financial institutions. It has the power to take preventive action against insufficiently capitalized institutions and may impose a legal structure as well as minimum capital requirements for banks. It also provides monetary and credit regulations aimed at ensuring the liquidity and solvency of banks as well as limiting the latter's exposure. To properly regulate the banking system, the CB can revoke bank licenses, resort to closure, rehabilitation or merger, and take other necessary steps to straighten out banks' affairs.

Since its organization in the late sixties, the BOI has played a very critical role in the promotion of industries; in recent years, however, BOI appears to be have acted more as a regulatory body. This change in the role of the BOI will be discussed in greater detail below.

As its name implies, HLURB's main function is to regulate land use, particularly in cities and urban areas. In particular, it is tasked with the processing/issuance of locational development permits and clearances in subdivisions and urban land reform and the monitoring of compliance with such permits, including the formulation of implementing rules and regulations. Formerly with the now-defunct Ministry of Human Settlements but now with the Office of the President, some of the functions of HLURB are transferred to local government units under the New Local Government Code.

The NTC was created out of the Telecommunications Control Bureau and the Board of Communications by virtue of EO 546 in 1979. NTC is tasked with the supervision, regulation and control of all telecommunications services in the country. Part of NTC's regulatory and control power is to approve or disapprove applications of telecommunications firms to enter the industry. Privately-owned telecommunications carriers provide services, charge rates and operate facilities under specific authorities (licenses) granted by NTC. According to EO 546, the principal functions of NTC are "to promulgate regulations as public safety and interest may require, to encourage a large and more effective use of communications, radio and television broadcasting, and **to maintain effective competition among private entities in these activities whenever the Commission finds it reasonably feasible**" (underscoring supplied). Until recently, however, these powers were exercised to deny the applications of firms to enter the telephone industry long monopolized by PLDT. It was only during the past few years that NTC has made some concessions to competition by allowing additional international gateways (see the case study on telephone services).

An agency under control and supervision of the DOTC, the CAB regulates the economic aspects of civil aviation, and exercises general supervision and regulation of, as well as jurisdiction and control over, air carriers, including their property rights, equipment, facilities, and franchise. In particular, CAB determines rates or fares charged by air carriers, prescribes and regulates their routes or areas of operations, and establishes standards and specifications concerning the Certificate of Public Convenience which it issues.

The LTFRB, created in 1987, absorbed the functions of the Land Transportation Commission. LTFRB's principal function is to process and approve or deny franchise applications. A corollary task is to determine whether existing routes are adequately served by franchise holders or whether unmet demand exists.

If air transportation has the CAB and land transportation the LTFRB, water transportation has the MARINA as regulator. MARINA absorbed the functions of the Board of Transportation pertaining to water transportation when the latter was abolished in 1985. MARINA is tasked with the overall development of the shipping industry, including the formulation and implementation of an integrated Maritime Industry Development Program. But an equally important function is regulation of the shipping industry. This includes determination of rates charged by owners/operators of liner services and control of the entry as well as exit of shipping vessels. On the former, MARINA determines rates charged based on cost recovery and a reasonable rate of return (12 percent a year).

Separate from MARINA but performing a complementary function is the PPA. Created in 1974 by virtue of PD 505, the powers of PPA include the regulation of port services, the selection of port operators, and determination as well as collection of fees for port- related services. Of particular interest to this study are the measures adopted by PPA which are aimed at "fostering efficiency in the provision of port services", but which in reality may have stifled competition: the one-port, one-operator rule granting monopoly to port operators, the power given them to collect fees from ship operators even if there is no work performed, the prohibition of the use of private ports, and compulsory pilotage in all public and private ports.

The Insurance Commission, a body under the operational supervision of the Department of Finance (DOF), performs three general functions, namely: regulation, supervision and adjudication on the insurance industry. Under its regulatory mandate, the Commission has the power to promulgate and implement rules and regulations governing insurance activities and institutions, license insurance firms as well as brokers, agents, etc., and rehabilitate/liquidate delinquent insurance companies as well as mutual benefit associations and charitable trusts. In pursuing its supervisory function, the Commission may examine the financial condition of insurance entities, review their premium rates, and evaluate their financial reports.

The SRA is responsible for the regulation and development of the sugar industry, including the allocation of sugar production and export quota. Similar functions, including the allocation of export quotas, are performed for the garment/ textile industries, by the GTEB. The PCA takes charge of the coconut industry. The ERB regulates and fixes prices on petroleum products.

The above overview of existing arrangements is not intended to be exhaustive. What is already evident from this proliferation of regulatory agencies is that regulatory concerns generally bear on entry, price/ rate fixing or quota allocation, market information, and externalities. [1]

For instance, the SEC, CB, Insurance Commission as well as public utility regulators like NTC, LTFRB, MARINA, PPA, CAB, etc. regulate entry of players in order to foster orderly development of the industry and to protect public interests. The SEC regulates establishment of corporations and may be stricter in the establishment of certain types like "pre-need" firms. The CB controls establishment of bank and non-bank financial institutions; the Insurance Commission, the setting-up of life and non-life insurance firms; both the SEC and the CB, finance companies.

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1 Noll (1989) defines three rationales for regulation: (a) natural monopoly, (b) imperfect information, and (c) the presence of external effects and public goods. See also Baron (1989).

Public utility regulators seek to reduce the potential for monopolistic abuse while trying to maximize efficiency advantages of monopoly. The public utility regulators and other agencies like ERB are also charged with regulating or fixing prices or rates to protect consumer interests.

Others like SEC, SRA, PCA, and GTEB seek to increase market information and cause the market to be a better, more competitive match between suppliers and demanders. For instance, GTEB sets minimum standards to keep domestic producers competitive in the world markets. This market information function may be linked with quota allocation as in the cases of GTEB or SRA.

Lastly, the presence of externalities and public goods are arguments for some form of regulation This is very evident in telecommunications where the NTC has to balance the need for cross-subsidies against the trend toward greater competition. In general terms, the overriding aim of regulation is supposedly to safeguard against market failure and protect public interests.

Regulatory Agencies as Entry Barriers

Earlier in Chapter III, the arguments why government implicitly or explicitly regulate entry have been discussed. Given the specific regulatory mandates, it is highly probable that regulators by virtue of their mandates or charters would restrict entry. CB restriction on the grant of commercial bank licenses or NTC control of telecommunications licenses can be regarded as within the scope of the regulatory concerns. Several cases, however, may be cited when the regulator departs from an efficient market outcome and becomes an entry barrier.

The regulator as captive

The "capture" a la Stigler (1968, 1971) is one instance when the regulator at times can serve as barrier to entry in the industry it is supposed to regulate. The Study Team has documented two cases of such Stiglerian capture from its survey of literature and its case studies.

The flour milling sector during the seventies is one such case according to Saldaña (1990). The regulator, the National Grains Authority (NGA), later the National Food Authority (NFA), acted to protect the interests of the regulated. Wheat allocation arrangements which it set up ensured the viability of every flour miller. Allocation decisions were done jointly by NGA with the industry and any adjustments arising from adverse market factors were done cooperatively (i.e. by agreement) rather than by market forces. The NGA also tolerated and accommodated the lobby of flour millers for regulated flour prices and reduced duties mainly because of a vested interest -- it was then the sole importer of wheat. Because of excess capacities then prevailing, the NGA also restricted entry into the industry.

The case study on cement is again illustrative of Stiglerian capture. During the 1970s through the 1980s, the sector displayed noncompetitive behavior. The government, however, condoned, even abetted, the situation. For instance, PCIA's approval was required to establish any new cement plant or to expand an existing one. Philippine Cement Corporation (Philcemcor) assisted the PCIA by monitoring the cement firms' rated capacities and providing the PCIA the information to base its decisions. This influence by the trade association on the direct entry restriction was evidently advantageous to the incumbents. Further, the PCIA delegated to Philcemcor the authority to set and enforce sales quotas, distribution areas, and other marketing regulations. Cement manufacturers therefore have been meeting at least monthly to discuss the previous month's sales performance and set production quotas for the following month. Even after the PCIA's abolition in 1987, Philcemcor's market arrangements are tolerated by government, this time represented by the DTI and the BOI.

A variant of "the regulator as captive" theme can be gleaned from positive experience during the Marcos regime when the coconut cartel, the United Coconut Oil Mills (Unicom) and the sugar monopoly, National Sugar Trading Corporation (Nasutra), were themselves dictating pricing and marketing policies, virtually shunting off their respective regulators.

The regulator as monopolist

The Philippines has seen the curious cases of the regulator as a monopolist, particularly during the Marcos regime. The anticompetitive actuations of NGA was discussed above. Not only did the NGA tolerate the cartel-like behavior of flour millers. It was itself a monopolist being the sole wheat importer, and because of this vested interest, it had to support the existence of a flour milling cartel which is its only market.

Napocor presents another example. EO 215 and lately the BOT law encouraged the private sector to enter into power generation. Under PD 40, however, the government power monopoly retains the authority to approve or disapprove projects. Many power projects have been stalled either because Napocor withheld approval of the projects or refused to reveal its utility avoided costs (that is, costs assumed by the private sector proponent, instead of the power monopoly, in putting up the project). There are now moves to transfer the approval process from the NAPOCOR to a committee under the Energy Coordinating Council (ECC).

The monopolist as regulator presents an institutionalized conflict of interests.

The regulator as bureaucrat

Many laws have been passed to facilitate entry or foster competition but failed to take off because of hurdles posed by implementing procedures. One recent case is the BOT law which is bugged by the protracted approval process.

Market-friendly laws and policies can lose their original thrusts when the regulator-implementor acts as bureaucrat.

The regulator as indifferent trustbuster

Lastly, the case of the regulator as an indifferent trustbuster can be cited to illustrate deviations from efficient market outcomes. Diffused responsibilities in implementation is seen as one reason why antitrust laws or competition-fostering policies have not been particularly effective. There is no single body tasked to enforce antitrust laws.

Another reason is the inability of officials to relate existing complementary laws, since they are primarily concerned with the provisions contained in statutes creating their respective agencies or those specifically mandating the agency to implement a law. For example, the SEC which is tasked to monitor corporate mergers or consolidations, rarely, if at all, goes beyond the provisions of the Corporation Code in evaluating the application for mergers, vertical integrations, or consolidations. It is doubtful whether the implications of such mergers vis-a-vis the national policy on the prevention of monopolies or unfair competition are taken into consideration, unless a third party opposes the merger and raises these issues during the appropriate proceedings. Even if it is determined to become proactive, it is improbable that the Commission would have the technical expertise, measures, and procedures to determine which mergers or acquisitions are beneficial or exclusionary.

Ineffective (or lack of) implementation also arises when the law is unclear on which agency should implement it. For instance, under the Omnibus Investments Code (PD 1789) as well as the Omnibus Investments Code of 1987 (EO 226), the BOI is required to certify that the entry of a non-Filipino firm "will not pose a clear and present danger of promoting monopolies or combinations in restraint of trade". However, this provision was explicitly repealed by the Foreign Investments Act of 1991. In other words, it would seem that the BOI, in approving the entry of foreign investments, need not take this criterion into consideration. Considering that multinationals have clearly dominated some industries in the country, it is not clear who then shall be tasked with safeguarding and promoting the competitive climate in the Philippines, as mandated by the Constitution and existing laws.

Moreover, it is possible that government agencies might have conflicting objectives. For instance, the APT has embarked on privatization of government assets to generate resources. In the process, it has provided several enterprises the opportunity to engage in monopolistic or unfair competition activities. The privatization and sale of Island Cement Corporation to the Solid Cement Corporation, for example, has allowed the Philippine Investment Management (Phinma) group to control almost half of the entire cement manufacturing industry. This has increased the possibility for restrictive business practices, although the Phinma group has not been observed to engage in overt predatory actions (see case study on cement in Volume II). This situation is certainly not the intended effect of privatization, being contrary to the State policy of enhancing competition. Nevertheless, this unwanted situation can arise especially if the priority of the agency tasked with privatization, is to dispose of the assets at the soonest possible time.

Another case in point is the takeover by Filipinas Synthetic Fiber Corporation (Filsyn) of Lakeview Industrial Corporation (LIC), which was foreclosed by DBP. BOI virtually forced Filsyn to take over LIC by making it as a condition for granting Filsyn's request for the extension of its tax exemption. Although the intentions were to do away with nonperforming assets held by the government and enhance the efficiency and viability of the industry, the takeover resulted in a monopolistic market structure in the manmade fiber industry that has persisted until today (see case study on polyester fiber in Volume II).

Finally, there is the perception (in some case, justified) of most bureaucrats that they lack the manpower to fulfill all their objectives adequately. Consequently, they are forced to set priorities and, more often than not, the prevention of antitrust activities or unfair practices are of a lower priority than others. Thus, the DTI has been unable to effectively enforce price control measures and the DOJ has been unable to prosecute violators of antitrust laws.

FOCUS ON THE BOARD OF INVESTMENTS

Given the above overview of the regulatory structure, we focus on the BOI to assess its record in promoting (or obstructing) entry into certain industries. Specifically, we intend to find out whether, in trying to fulfill its mandate, BOI has instead served as a barrier to entry to certain industries, and, if so, what changes are necessary to restore it to its original mandate or make it a more facilitative institution.

Original Mission

BOI was chosen as the focus of this discussion on institutional arrangements due to its central role in promoting industrial development. Through promotional instruments such as incentives, BOI is tasked to stimulate the entry of investments in preferred sectors and thereby expand the industrial base of the country.

Guiding principle

BOI was organized in 1968 by virtue of RA 5186, known as the Investment Incentives Act of 1967. In its "Declaration of Investment Policies", RA 5186 states as its guiding principle,

> ". . .to accelerate the sound development of the national economy in consonance with the principles and objectives of economic nationalism and in pursuance of a planned economically feasible and practicable dispersal of industries and the promotion of small and medium scale industries **under conditions which will encourage competition and discourage monopolies....**"(underscoring supplied)

To realize its foregoing objectives, BOI is invested with the following major functions and powers under RA 5186:

- Draw up annually an investments priorities plan;

- Process and approve applications for registration under RA 5186 and issue the proper certificate of registration;

- Decide controversies arising between registered enterprises or investors and government agencies concerning the implementation of the Act;

- Periodically check and verify the compliance by registered enterprises with the provisions of this Act and with the terms and conditions of registration;

- Cancel the registration or suspend the enjoyment of incentive benefits of any registered enterprise for either of the following:

    - failure to maintain the qualifications required by this Act for registration;

    - for willful or grossly negligent violation of any provision of this Act, of the rules and regulations issued under this Act, or the terms and conditions of registration, or of laws for the protection of labor or of the consuming public;

- Promulgate such rules and regulations as may be necessary to implement the provisions of the Act;

The foregoing enumeration indicates the wide discretionary powers of the BOI, centering on: preparation of the IPP, processing of applications for registration of enterprises (under the Plan) and approval of incentive availments, and periodically checking compliance by enterprises with the terms of registration.

The Investment Priorities Plan (IPP)

BOI's central role in the country's industrial development program stems from its power to define priority areas of investment and grant (or withhold) and administer a wide variety of incentives to enterprises that qualify under its evaluation criteria.

Annually, in accordance with RA 5186, the BOI draws up an IPP in which is listed the priority areas of investment. The Plan also forecasts the supply and demand situation in order to determine whether measured capacity exists and whether such industries qualify for the various incentives granted by the BOI.

In drawing up the IPP, the BOI conducts hearings and consults representatives of various industries/ industry groups. In preparing the IPP, BOI is explicitly instructed to take into consideration the following factors:

- the existing and prospective demands for specific products and commodities, considering the level and structure of income, production, trade, prices and relevant factors;
- the existing capacities for producing specific products and commodities;
- the gaps between prospective demand and existing supply for specific products and commodities, and the additional production capacities that must be induced where such gaps exist;
- the specific products and commodities whose export should be encouraged;
- the specific areas of economic activity to be declared preferred and pioneer areas of investments and the corresponding measured capacities thereof;
- the capital investments necessary to bring such additional capacities into existence;
- the raw material and manpower requirements of the additional production capacities;
- the location of the additional capacities, considering the availability of natural resources, labor, transport facilities, power, water supply and the like;
- the roles and responsibilities of the private sector and the government in bringing the additional capacities into existence;
- the specific public works projects and capital investments projects that need to be undertaken by the government to make private investments feasible;
- the prospective impact of the projected investments on prices, the exchange rate and the balance of payments;
- the changes in tariffs necessary for the protection of infant industries;
- the minimum requirements for maintaining conditions of competition in industry;

BOI may also take into consideration other relevant factors. But it is important to note the very explicit recognition, in the guiding principles and in the other provisions of the Act, the need for the BOI to maintain competition in industry.

After the IPP is prepared by the BOI, it goes to NEDA which evaluates its consistency with the national development plan. If it agrees with the IPP, NEDA recommends the Plan to the President for signature. When the President approves the IPP, it acquires the status of a law.

Benefits and privileges administered by the BOI

To industries selected as priority by the BOI, a number of basic rights and guarantees are given. For foreign investors, the following incentives are given: repatriation of investments, remittance of earnings; freedom from expropriation; protection of patents and other proprietary rights, and capital gains tax exemption.

For Philippine nationals investing in pioneer enterprises, incentives including tax allowance for investments, capital gains tax exemption, and tax exemption on sale of stock dividends are offered.

For a registered enterprise, the following benefits are available: deduction of organizational and pre-operating expenses; accelerated depreciation; net operating loss carry- over; tax exemption on imported capital equipment; tax credit on domestic capital equipment; tax credit on withholding tax on interest; employment of foreign nationals; deduction for expansion reinvestment; anti-dumping protection; and protection from government competition.

There are other incentives offered to pioneer and/or preferred as well as export and agricultural enterprises.

BOI as an Entry Barrier

In recent years, serious questions have been raised on the broad discretionary powers of the BOI. Relatedly, there have been issues arising from BOI's tendency to act as a regulatory body, concerned largely with monitoring compliance of registration conditions by BOI-registered firms, rather than acting as a promotional body. We are highlighting these issues to the extent that certain actuations of the BOI might have deterred entry or served to protect incumbents against new competitors. We also suppose that the anticompetitive effects of these moves might have been unintended.

Arbitrariness in the listing or delisting of industries

It can be noted, for instance, that there is substantial arbitrariness in the listing or delisting of industries under the IPP. **Table 5.1** presents the list of preferred economic activities without distinguishing whether they are pioneer or non-pioneer industries during the period 1986-1991.[2] At least two observations can be made here.

- The number of preferred activities has substantially declined, in 1991 but even more so in 1992. This is due to policy of the government to limit as much as possible the number of preferred economic activities, which is an appropriate thrust as it reduces the potential fiscal burden on government.

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2 As of this writing, the IPP for 1992 has not yet been finalized. According to key informants within the BOI, the draft 1992 IPP has made substantial cuts the preferential areas.

- There are several economic activities that have been dropped from the IPP list, but were reinstated in the subsequent years. The main reason for this is to expand capacity by encouraging existing firms to increase their plant capacity or invite new entrants. There are instances, however, in which BOI's decision is made not to encourage entrants into the industry but to accommodate requests by incumbents that wish to enjoy the fiscal incentives. This is true of the steel industry (no. 28 of **Table 5.1**) and of the aerospace engineering industry (no. 17). This is where arbitrariness can arise.

The decision of the BOI to include and classify certain industries in the IPP as pioneer or non-pioneer industries has been questioned in several circumstances by incumbents. A case in point is the decision of BOI to give manmade fiber a pioneer/ non-pioneer status, which would have been availed of by the potential entrant, but had been questioned by incumbent all the way up to the Supreme Court (see Volume II of this report).

A recent case is the BOI amendment to the 1991 IPP to lift the locational ban of cement projects in landlocked areas. This allows an existing firm, the Continental Cement Corporation, to push through with the expansion of its plant at Norzagaray, Bulacan. The site is landlocked and, before the amendment, does not qualify for incentives.

Discretionary granting of incentives

Also questioned by critics is the wide discretion in the award of incentives. Central to the determination of whether an industry qualifies for the incentives offered by the BOI is the controversial concept of "measured capacity".

The Omnibus Investments Code (PD 1789) defines "measured capacity" as "the additional volume of production or service which the BOI determines to be desirable in each preferred area of investment in order to supply the needs of the economy at reasonable prices, taking into account the export potential of the product, including the economies of scale which would render such product competitive in the world market". In other words, it refers to the estimated gap between demand (including export demand) and domestic capacity.

The existence of a demand-supply gap (with demand exceeding available supply and production capacity) indicates that there is room for other firms or that there is scope for expansion in the production capacity of existing firms. On the other hand, its absence indicates the field is already overcrowded and therefore entry is no longer encouraged.

Table 5.1
List of Preferred Economic Activities: 1986-1991

ACTIVITY	1986	1987	1988	1989	1990	1991
I. Agriculture						
1. Production of food crops	X	X	X	X	X	X
2. Production of feed grains	X	X	•	X		X
3. Production of feed ingredients and feeds	X	X				
4. Production of plantation & other crops	X	X	X	X	X	
5. Development & prdn of planting matls	X	X	X	X	X	
6. Production of ornamental plants	X	X				
7. Production/processing of agri-cultural inputs	X	X	X	X	X	X
8. Production of livestock & poultry	X	X	X	X	X	X
9. Production of breeders	X	X	X	X	X	
10. Production of beverage crops			X	X	X	
11. Production of fiber crops			X	X	X	
12. Agricultural services	X	X	X	X	X	X
II. Forestry	X	X	X	X	X	X
III. Fishery						
1. Marine fishing	X	X	X	X	X	X
2. Aquaculture	X	X	X	X	X	X
IV. Mining						
1. Exploration & mines development	X	X	X	X	X	X
2. Mining & quarrying of metallic/ non-metallic minerals	X	X	X	X	X	X
3. Processing of minerals such as beneficiation & other metallur-gical methods	X	X	X	X	X	X
V. Manufacturing						
1. Processed food	X	X	X	X	X	
2. Wood products	X	X			X	
3. Pulp and paper	X	X		X	X	X
4. Textile & textile products	X	X	X	X	X	X
5. Footwear	X	X				
6. Leather products	X	X	X	X	X	
7. Chemical products	X	X	X	X	X	X
8. Pharmaceuticals	X	X	X	X	X	X
9. Rubber products	X	X	X	X		
10. Plastic products	X	X				
11. Non-metallic mineral products	X	X	X	X	X	
12. Structural materials/construction/ housing components	X	X				

Table 5.1
List of Preferred Economic Activities, 1986-1991

ACTIVITY	1986	1987	1988	1989	1990	1991
13. Machinery & equipment	X	X	X	X	X	
14. Electronic products, machinery/ equipment, their related spare parts, accessories & supplies	X	X	X	X	X	X
15. Electrical machinery/equipment, their related spare parts, accessories & supplies	X	X	X	X	X	
16. Shipbuilding & shiprepair	X	X	X	X	X	X
17. Aerospace engineering	X	X			X	
18. Miscellaneous manufactured products for the following industries:						
a. Apparel	X	X				
b. Footwear/leathergoods	X	X				
c. Processed food	X	X				
d. Giftwares, handicrafts & accessories	X	X				
e. Furniture	X	X				
f. Health care	X	X				
g. Sporting goods	X	X				
h. Metalworking	X	X				
i. Scientific instruments	X	X				
j. Custom–built vintage cars	X	X				
19. Rationalization/rehabilitation/ modernization of industrial plants						
a. Plywood plants	X	X	X	X	X	
b. Veneer plants	X	X	X	X	X	
c. Pulp and paper mills	X	X	X	X	X	
d. Powdered milk plants	X	X				
e. Textile mills	X	X	X	X	X	
f. Cement plants	X	X	X			
g. Metalworking shops	X	X	X	X	X	
h. Product test laboratories	X	X	X	X	X	
i. Nickel smelting/refining	X	X				
j. Shipbuilding & shiprepair	X	X	X	X	X	
k. Basic chemical plants	X	X		X	X	
l. Conversion of detergent mfg facilities to coconut fatty feedstock	X	X				
m. Components for the Progressive car & truck mfg prgs	X	X				
n. Components for the Progressive motorcycle mfg prg	X	X				
o. Program for coconut industry			X	X	X	
p. Glass container plants				X	X	
q. Semiconductor plants				X	X	
r. Furniture industry					X	
s. Other industrial plants as determined by BOI after thorough study	X	X	X	X	X	

Table 5.1
List of Preferred Economic Activities, 1986-1991

ACTIVITY	1986	1987	1988	1989	1990	1991
20. DFA–based toilet soap mfg			X			
21. Pre–cast & prefabricated walls & components using nontraditional indigeneous materials			X	X	X	X
22. Automotive parts & components			X	X	X	X
23. Packaging Materials				X	X	
24. Metal products & support services				X	X	X
25. Rehabilitation & modernization of existing raw sugar factories & sugar refineries						X
26. Refined petroleum products						X
27. Cement						X
28. Primary & secondary processing of ferrous metals						X
VI. Energy–related Projects						
1. Alcohol production for fuel with or without integration with agricultural prodn of raw mat'ls therefor	X	X	X	X	X	
2. Production of fuel or energy through the conversion or transformation of biomass materials, coal & charcoal into more usable forms of fuel	X	X	X	X	X	
3. Establishment of mfg plant substantially using coal as fuel, geothermal & other non–conventional fuels; or conversion of existing mfg plants/eqpt for the use of coal & non–conventional fuels	X	X	X	X	X	
4. Manufacture of eqpt necessary for the prodn and/or utilization of solar energy, power, alcohol, biogas, geothermal steam or geothermal hot water, wind, coal–derived fuels & other fuels certified by the Ministry of Energy to be of non–conventional nature	X	X	X	X	X	
5. Manufacture of mini hydro–electric systems	X	X				
6. Any manufacturing plant essentially using non–conventional energy device, process or system	X	X				
7. Energy co–generating plants	X	X	X	X	X	
8. Power–generating plants	X	X	X	X	X	X

List of Preferred Economic Activities, 1986-1991

ACTIVITY	1986	1987	1988	1989	1990	1991
VII. Projects promoting the conservation & more efficient use of energy						
1. Installation of new eqpt or modernization of existing eqpt leading to improvements in the efficiency w/ w/c energy is used	X	X				
2. Installation of new eqpt or conversion of existing eqpt to enable the replacement of one form of energy w/ another	X	X				
3. Installation of new mfg plant or process, or modernization of existing manufacturing plant or process, resulting in more efficient utilization of energy than currently achieved	X	X				
4. Installation of waste energy recovery system	X	X	X	X	X	
5. Installation of eqpt & materials to improve energy utilization in buildings	X	X				
6. Manufacture of eqpt for specific use in the energy conservation projects	X	X	X	X	X	
7. Installation of instruments & control devices leading to improvement in the efficiency of energy use				X	X	
VIII. Public Utilities						
1. Interisland shipping & directly related facilities essential to the efficient operation of ships	X	X	X	X	X	X
2. District cooling systems	X	X				
3. Overseas shipping	X	X		X	X	X
4. All-cargo airlines	X	X		X	X	
5. Telephone & telegraph services in less developed areas	X	X	X	X	X	X
6. Mass transport operations				X	X	X
7. Land transport cargo handling operations					X	X
8. Port cargo handling services					X	X
9. Electric distribution system in less less developed areas					X	
IX. Export traders	X	X	X		X	
X. Service exporters	X	X	X	X	X	
XI. Tourism-oriented services			X	X	X	X

List of Preferred Economic Activities, 1986-1991

ACTIVITY	1986	1987	1988	1989	1990	1991
XII. Infrastructure/Industrial service facilities						
1. Industrial estates, including Science and Technology Parks, Technology Incubation Centers and Science and Technology Centers				X	X	X
2. Common service facilities			X	X	X	X
3. Industrial & hazardous waste mgt services			X	X	X	
4. Industries supporting exporters			X	X	X	X
5. Development of retirement villages, incldg health & medical facilities				X	X	
XIII. Research & development activities which are science– and technology–oriented				X	X	X

Source: Investment Priority Plan 1986, 1988, 1989, 1990, 1991.

In the former case, the BOI grants incentives to firms entering the industry; in the latter case, BOI discourages entry by withholding or not giving incentives. RA 5186 explicitly provides that the BOI "shall cease to register any enterprise in a preferred or pioneer area of investment when the measured capacity therein has been filled."

Conceptually therefore, the exclusion of the industry from the IPP confers absolute advantages to the incumbents equal to the discounted present value of the incentives given. In addition, the deterrence of entry resulting therefrom could lead to monopolistic pricing by the incumbent. It should be noted that this is distinct from the advantages already conferred by the incentives.

Two cases decided by the BOI illustrate how the concept of measured capacity has been applied. The first case involves the application of two firms to manufacture sodium tripolyphosphate. Since the measured capacity of 17,000 metric tons (MT) could be produced by a single economic-size firm, only one of the applications was approved for registration by the BOI.

The other case involves the application for registration with the BOI of two firms who wanted to put up an aluminum smelting plant. The measured capacity was estimated to be 36,000 MT. In this case, although the measured capacity could be filled up by either one of the applicants, the BOI felt that the approval of either project alone would "jeopardize the success of the project". What the BOI did was to bring together the two applicants to jointly establish the aluminum smelting plant. It is evident in this case that the BOI acted to preempt a possible price war between the two.

Both cases were decided in the late sixties, during the early years of the BOI. It is possible that the interpretation of the concept has evolved over the years, i.e., become stricter or more liberal. The Omnibus Investments Code of 1987 provides for the regular review of estimates of measured capacity "to reflect changes in market supply and demand conditions." The Code further provides that measured capacity "shall not result in a monopoly in any preferred area of investment which would unduly restrict trade and fair competition, nor shall it be used to deny the entry of one enterprise in any field of endeavor or activity."

Despite these safeguards, examination of available published materials suggest that the application of the test of measured capacity may in the past have served as a barrier to entry, and hence contributed to the monopolistic or oligopolistic structure prevailing in certain industries.

Other pieces of evidence support this hypothesis: the case of the brewery industry, which was classified as an overcrowded industry, despite the presence at that time of only one participant; and cement, in which there has been an alternation of periods of excess demand (shortage) and excess supply (surplus) depending on the state of the economy (see Volume II of this report). The intravenous (IV) fluids case involving the University of the Philippines-Philippine General Hospital (UP-PGH) is the most recent one (see Box 5.1).

The same Code, moreover, made sure that measured capacity is not overlooked when it defined one of the duties of the BOI as-

> "..... to formulate and implement rationalization programs for certain industries whose operation may result in dislocation, overcrowding or inefficient use of resources, thus impeding economic growth".

If, indeed, the BOI has stifled competition, this may have been an unintended outcome of its application of the concept of measured capacity. RA 5186 is very clear in its intention, quoted earlier, to discourage monopolies and encourage competition; it would be ironic if BOI achieved the exact opposite.

There are, however, indications that the BOI is moving away from a strict application of measured capacity, if not from the use of the criterion altogether. According to a key informant (one of the BOI Governors interviewed for this study), BOI actually no longer uses measured capacity as a test for entry into industry and consequent entitlement to BOI incentives. An enterprise seeking to enter a field or activity is now practically free to do so as long as it is listed in the IPP.

Moreover, unlike the previous investment incentives laws, the Foreign Investments Act of 1991 makes no mention of measured capacity. This represents a considerable relaxation of the requirements for entry to industry and a big step towards a more competitive policy environment in the country. As pointed out earlier, some provisions in the Act and in the Implementing Rules and Regulations of the Act, however, seem to send a different message. Included in the criteria for inclusion in List C are the following: "Industry capacity is ample to meet domestic demand;" and "Sufficient competition exists within the industry." Certainly, both criteria suggest some kind of measured capacity for the industry.

The point of the foregoing discussion is the need to reduce the discretionary power of the implementing agency, place screening of priority projects on an automatic basis, and make the award of incentives more transparent.

Removal of risks

A related and deeper issue is whether in offering these incentives, BOI may have removed some of the risks that are inherent in any business activity. In such a sheltered environment, profitability is increased by "administrative fiat" (award of incentives) to attract investments.

Indeed, the impact of BOI fiscal incentives on the profitability of recipient firms is not insignificant. Sumulong (1992) finds that the investment incentives (i.e., income tax holiday and tax exemption on imported capital equipment and tax credit on domestic capital equipment but excluding the impact of the deductions from labor expenses) will increase the rate of return by at least 12 percentage points for pioneer firms and by 10 percentage points by non-pioneer firms.

BOX 5.1 ON MEASURED CAPACITY AND WHATEVER MEANS

What happens when a domestic firm decides to go into production of a good not widely available locally? It has to contend with the BOI and grapple with the concept of measured capacity.

This happened to the proposed intravenous (IV) fluid project of the University of the Philippines - Philippine General Hospital (UP-PGH). Considering the high demand for IV fluids, the UP-PGH wanted to go into hospital-based IV production. The project will develop dexstrose from cassava starch produced by the Mirasal Starch Farm Corporation in Iloilo.

However, as Manlu Crisostomo of *Daily Globe* relates (20 December 1991), the BOI is trying to discourage the PGH move "because it has laid out incentives to some national and multinational companies producing IV fluids."

Tomas I. Alcantara, Vice Chairman and Managing Head of BOI, makes the following clarifications:

- The recommendation to establish an IV fluids facility at UP-PGH was proposed by a United Nations Industrial Development Organization (UNIDO) study conducted when there was only one producer of IV fluids, Abbott Laboratories. In view of this monopoly, the BOI listed the production of parenteral therapy systems as a preferred activity under the Investment Priorities Plan (IPP).

  As a result, four new IV fluids projects were registered with the BOI, namely, Euro-Med Laboratories, LVP Philippines, Mediflex Healthcare, and Otsuka-Marsman. The projects were granted incentives as provided under Executive Order No. 330.

- The total capacity of the four newly registered projects is about 17 million liters per year. This total capacity, added to that of Abbott Laboratories, is deemed sufficient to fill the demand for large volume parenterals in the near future. Because of this, the BOI has already limited the IPP listing to the production of small volume parenterals.

- Inasmuch as the private sector has proven to be capable of supplying the domestic market, there does not seem to be a need for the government to establish another IV fluids plant which would directly compete with the private companies.

This simple case illustrates how a government agency tasked to promote industries can restrict entry. First, it seeks to encourage entry by means of incentives. When through measured capacity or whatever means it decides there is now adequate supply, it discourages entry. In effect, the first few entrants get protected from further competition. Over time, barriers solidify and the incumbents become entrenched.

This definitely is a substantial advantage conferred to incumbent firms which receive such incentives. Potential entrants that will not enjoy such incentives because the sector is already delisted from the IPP would find themselves in a seriously disadvantaged position. Even though there is no prohibition against entry by other firms, the exclusion from such incentives will make them less competitive. Therefore, the BOI fiscal incentives given to a limited number of firms within the industry serves as a formidable entry barrier.

Moreover, studies have shown that fiscal incentives are not a major consideration in firms' decision to invest in a particular country. Rather, what is more important is a country's political stability and the predictability of its policies. Manasan (1988) finds the Philippines is at par with ASEAN countries with respect to fiscal incentives to foreign investments. But as demonstrated in the last few years, the Philippines received less foreign investments than other ASEAN countries because of relatively unstable political situation.

Cumbersome procedures

The World Bank (July 1987) notes that the incentive system has been simplified under BP 391 and the Omnibus Investments Code. However, the approval process is said to be "complicated, time- consuming, perhaps intimidating, and has to be conducted in Manila." The same World bank study points out that the cumbersome procedures have acted as a barrier to small firms. If an enterprise misunderstands how the system works or simply gives up in availing of the system, then the purpose of incentives is defeated.

To its credit, the BOI has greatly streamlined its registration procedures since then. According to key informants, the BOI is self-driven to process a submitted application for incentives within 12-14 days. The applicant only has to publish the proposed business in a newspaper of general circulation. BOI allots one week for reactions. If there is no serious objection, the BOI must render its final decision within 20 working days. In this case, the onus of disapproving a project is placed on BOI.

Dilution of mission

Closer integration of the Board with or under the DTI may have led to the dilution of its mission. Originally, the Board was a fully independent body with five fulltime governors. An organizational move has made the Board a virtual bureau of the DTI even as it resulted in the expansion of the number of BOI Governors and in the increase in the number of DTI officials in the BOI Board. The impact of this development is not easy to determine.

On one hand, it makes for close coordination between agencies performing related functions as well as for consistency of policy; on the other hand, it diminishes the independence that characterized the early years of the BOI when its governors were fulltime.

The change may be regarded as undesirable to the extent that the change in the composition of the board makes the BOI vulnerable to political pressures (since DTI officials in the BOI Board are political appointees) and to extra-economic considerations. Another key informant (a former governor of the BOI) opines that the change made the BOI a mere appendage of the DTI.

But over and above these changes, there has also been a shift, over the years, in the focus of BOI's activities, which has diluted its effectiveness in its primary function of promoting investments. The BOI has been involved in "extraneous" (according to another key informant who was former head of the BOI) activities like allocation of credit and foreign exchange (which properly belongs to the Central Bank) and (particularly under former Trade and Industry Minister Roberto Ongpin) the promotion of the so-called "major industrial projects" of the Marcos administration. In the process, BOI has assumed more and more the role of a regulatory agency, which it was not meant to be under RA 5186.

Towards a Redirection and Refocusing of BOI's Efforts

As stated earlier, the BOI was established at a time when the dominant development ideology called for active state intervention in and planning and direction of the economy. An in-house publication of BOI spelled out this activist role when it stated that "the BOI, through a scheme of tax and other fiscal incentives, would direct domestic and foreign investments into preferred areas of industrial activity that would support a **planned economic development program**" (underscoring supplied).

Such a philosophy that underpinned the BOI as well as other planning agencies, including the NEDA, has, in recent years, come under serious and sustained attack from business and academic circles. In the more advanced capitalist, not to mention socialist, countries, the state has been on the retreat during the decade of the eighties.

Thus, after more than two decades of BOI's existence, its role needs to be reexamined. As stated earlier, studies have shown that fiscal and other incentives of the kind given by BOI are not really the overriding consideration for foreign and domestic investors. What is more important to them are the economic fundamentals -- peace and order, infrastructure, political stability, policy consistency and predictability, relative ease in entry and exit, and the like. The presence of such fundamentals would serve to remove some of the uncertainty (but not necessarily the risks, which are inherent in any business venture) surrounding the investment decision and thus enable investors to plan confidently for the future.

Critical as it may be, the foregoing analysis suggests neither the abolition of the BOI nor its downgrading as an institution, but perhaps a redirection and refocusing of its efforts -- away from the incentive-giving and compliance-monitoring functions toward promoting investment, including the "uncovering of new investment opportunities", to borrow the words of Senator and former BOI Chairman Paterno.

Such change in direction or focus is in fact already recognized by, and may already be happening within, BOI. For instance, in its *1988 Annual Report*, BOI stressed the need to highlight promotional programs "in view of the withdrawal of Generalized System of Preferences (GSP) privileges in the US, appreciation of currencies of target countries, increasing labor costs, and presence of labor turmoil". This suggests, if anything, a recognition within BOI of a more active promotional role for the agency.

Recent actuations of the BOI also indicate a shift from its regulatory role. The drastic reduction in the number of areas included in the latest IPP is a step away from BOI's incentive-giving and compliance monitoring role. Also, "measured capacity" has been practically abandoned, albeit by administrative discretion or practice.

For the redirection of BOI to get a much-needed push, the legislation that specifically mandates it to perform the tasks and responsibilities that we believe it has been unnecessarily saddled with must, however, first be repealed or amended. According to Governor Thomas Aquino, BOI is already being pushed in the desired direction to the farthest extent legally possible, i.e. to the extent allowed by its enabling legislation. But the law, and in particular the provision on measured capacity, must at some point have to be repealed or amended. This should be a high priority in the legislative agenda of the next Congress.

VI SOCIO-POLITICAL FACTORS AFFECTING REFORMS

THE PROCESS OF REFORM

The explicit consideration of market power raises questions on several levels regarding the process of reform.

Previous work by economists and other social scientists has already underscored the importance of the "political-economy" issue. The main insight contributed by this viewpoint is the premise that economic policies cannot be conceived of as arising in a vacuum but are the outcome of the actions of defined social groups pursuing their interests. In economics this has given rise to the entire literature on "rent-seeking" (Tullock originally and later Krueger, 1974), Findlay and Wellisz 1982, among others). The upshot of this is that social resources will be expended by interest groups in order to capture benefits (or prevent losses) from a particular turn of policy, e.g. protection or devaluation. Policy therefore is not "designed" but is the outcome of a social process of conflict and bargaining.

In political science and sociology the relevant stream of literature is that dealing with the role of the "developmental state" or its "relative autonomy" (see Hutchcroft,1990; Haggard, 1990) vis-a-vis economic elites. It is considered necessary that the state, if it is to be "developmental", must at once be able to stimulate and discipline the elite and rechannel, if not minimize, its rent-seeking activities.

What does the addition of industrial organization add to these notions?

Industries and Groups

One obvious effect is a reconsideration of the degree of lobbying by those supporting or opposed to certain types of policies. It is a corollary from Mancur Olson that smaller numbers are better able to provide themselves with collective goods, since transactions costs are lower. One would expect lobby-formation to be easier for smaller groups with focused interests than for large groups (e.g. consumers) for whom both gains and losses from a policy change are small and diffuse. Arrow (1974) some time ago speculated that for this reason

> ". . . .It may well be that the exchange of information leading to a collusive agreement among producers of one commodity is much cheaper than that needed to achieve a blocking coalition. Hence the collusive agreement may in fact be stable."

It should come as no surprise, therefore that the degree of resistance to moves towards greater competition has been high. To the extent changes in the trade-regime partly correspond to a pro-competition policy, some of this resistance has been tested in the debate over the import-liberalization and tariff reform. Lobbying activity should increase as the government and public opinion take pro-competitive policy more seriously.

One manifestation of this has been the increase in advertising by virtual monopolists, such as PLDT or NSC, or the participants in the CDP, which have all recently come under threat. It should also be expected, of course, that other more effective forms of persuasion than advertising may be directed at key policymakers. From the viewpoint of the rent-seeking school, of course, such expenditures and efforts are directly unproductive if they are not mere transfers.

The social influence of interests in concentrated industries becomes more formidable when it is considered that very often, these are merely part of larger "groups" or conglomerates, i.e. firms in different industries with ownership interrelated through kinship, real or fictive, or at times political affiliation, often organized with their own bank. The existence of such groups is a peculiar characteristic of the industrial organization in developing countries (as described e.g. by Leff 1978).

Before, during and after the Marcos dictatorship, for example, various Groups competed for dominance in specific economic spheres or "parcels" (Ferrer 1988). The struggle of the Romualdez Group and the Lopez Group for control of the Meralco monopoly on electric distribution and telecommunications, among others is illustrative. Earlier, the Jacintos and the Elizaldes also competed over the setting up of a cold-rolling mill in the country. It will also be noted that, especially in the Philippine context, many of these contests were resolved through a political process.

The specific economic or sociological function (if any) performed by the existence of such groups in the context of developing countries does not appear to have been fully elaborated. Current writing does not seem to ascribe much purpose to these beyond mere collusion and rent seeking. On the other hand, it is at least plausible that among other things they also serve to overcome the segmentation of capital markets by ensuring financing and facilitating diversification. Others might even take the extreme view that in certain circumstances they may perform a developmental role, as have the *zaibatsu* of Japan and *chaebol* of Korea. On the other hand other writers (Ferrer 1988) have also pointed to the prevalence of extra-economic, especially political, mechanisms as means of wealth-accumulation as a prime reason for Philippine underdevelopment.

Unfortunately a more thorough and definitive discussion is beyond the scope of this report. For present purposes, however, it is sufficient to note that the recognition of the prevalence of such Groups (rather than firms or industries per se) as key actors in economics and politics implies that lobbying and rent- seeking encompass a wider scope of actions than is commonly supposed. The potential arena in which resistance is displayed may include not only the typical lobbying and publicity, but also the use of the political system itself. That this is indeed possible is shown by the large rearrangements of elite property during and after the Marcos regime, a process whose final results are still uncertain.

A second broad implication of the recognition of groups, however, is that the political economy of concentrated industries may not always run along lines of collusion. Competition in other branches of the economy or in politics may influence the state of collusion or competition between interests in a particular branch, since they may belong to different groups, or stakes larger than profits in that particular industry are involved.

Rent-seeking and Entry Barriers

Conceptually, therefore, the persistence of various groups may act both to reinforce or to weaken existing resistance to pro- competitive policies in a particular industry. This raises the question whether competition among groups is a help or a hindrance in guaranteeing contestability in markets.

From a normative viewpoint, this issue is relevant to the question of whether rent-seeking activity is monopolistically assigned or competitive. The theory of rent-seeking as put forward by Tullock and Krueger emphasizes its wastefulness in the dissipation of resources equal in value to the discounted present value of the rents to be enjoyed. In the case of a monopoly privilege, for example, a prospective monopolist would be willing to spend as much as the present value of the stream of monopoly benefits multiplied by the probability of winning. From this it is not difficult to see that the amounts spent by all participants on lobbying could match the entire prize. This represents a waste of resources on the part of society, although on the part of the rent-seekers the expenditures may be entirely rational

This suggests the possibility for some that monopolistic rent-seeking is possibly less wasteful. The regime under Marcos has been characterized as one of monopolistic rent-seeking. On the other hand, rent-seeking under the Aquino administration is regarded as competitive. From a pure efficiency viewpoint, one would regard monopolistic rent-seeking as superior to competitive rent-seeking, since the deadweight losses are theoretically less under the former than under the latter.

On the other hand, from another viewpoint, it has been pointed out that competitive rent-seeking is more politically stable than monopolistic rent-seeking. Intuitively, the availability of legal avenues for the "outs" to come into their own lessens the likelihood they will seek to change the rules of the game. The prominent participation of the elite in the revolutionary overthrow of the Marcos regime (and the resilience since then of democratic forms, based on the prospect of elections) is an important demonstration supporting that hypothesis. Nevertheless, this "trade- off" between political stability afforded by competitive rent- seeking on the one hand and the presumed waste of resources it entails on the other is one of the principal dilemmas for Philippine political economy.

It is also doubtful whether competition among Groups for an industry in the domestic context necessarily implies greater contestability. Group competition may also be limited to taking over particular "parcels" (Ferrer's term) of property without changing their economic function.

Consider the case of a monopolist making excess profits. Contestability would normally require the potential entrant threaten to or actually enter the market, in this manner lowering prices and profits, ending the monopoly. Where it is possible to use political means to change property relations, however, this may prove more attractive. Hence it is likely that competition among Groups may be essentially be conservative. It is doubtful, for example, whether the changes in ownership of enterprises that occurred under the Aquino administration -- in themselves and apart from the larger changes such as trade reforms -- have significantly changed the manner in which many crony enterprises operate. (Notable exceptions, however, are the prominent and controversial marketing monopolies in sugar and coconut.)

"Strong" and "Weak" States

The fact that Groups in some Newly Industrialized Economies (NIEs) have played an important role in economic development -- while in the Philippines they have not -- raises the question of the relationship between the state and Groups, or more generally between the state and economic elites. The distinction between "strong" and "weak" states is made by political scientists. A "strong" state is one that is "relatively autonomous" with respect to civil society but especially with respect to dominant social interests, one that is capable both of disciplining.and stimulating entrepreneurial behavior. A "weak" state, on the other hand, is one that can be neutralized, if not entirely "captured" by elites to prevent damage to their interests.

Applied to the issue of groups and conglomerates, the emerging consensus is that the states in Japan and some of the NIEs were "strong"; their ability to discipline the pre-existing Groups in those countries could explain the positive role these played in development. On the other hand, it has become somewhat fashionable to characterize the Philippine state as "weak" or "soft", in that instead of disciplining business groups, it has become a captive of rent-seeking interests.

It would be wrong, however, to regard the distinction between "strong" and "weak" states as identical to a dichotomy between democracy and dictatorship. Again the Philippine (and perhaps also Latin American) experience provides the counter-example. The Marcos regime in particular was not a definitive experiment in a "strong state". While the executive branch may have been predominant in Marcos's time, it did not necessarily mean the state was autonomous enough to pry itself off the dependence on the traditional elite. The permeation of particularist interests (as epitomized by the failed crony-capitalist phenomenon) during the Marcos regime was a large explanation for the failure of the economy during that period (see the UPSE "White Paper" edited by de Dios 1984).

At best it would have been an example of "weak authoritarianism" (Haggard 1990), or a strong executive within a weak state. Almost needless to say, a weak executive in a weak state -- as is the case under the present administration -- compounds the problem even further. It is only to be expected that under such circumstances, policymaking is likely to be less consistent, with rent-seeking more pronounced. Conceptually the executive -- centered on the president and the cabinet -- is more capable of unified decision-making and consistency than legislatures which are divided along party lines and hence prone to log-rolling or cyclicity.

Except for a brief period when it technically ruled under a dictatorship between February 1986 and May 1987, the Aquino government has functioned mostly under democratic institutions and processes. The new constitution trimmed the powers of the executive and shifted the center of political gravity to the legislature. The convening of Congress effectively set up a power center that provided a formal vehicle for the expression of interests by traditional elites.

DILEMMA OF DEMOCRATIC REFORMISM

The performance of the Aquino administration has led to a general conclusion -- at times unwarranted -- regarding the generic difficulties of reform under democratic institutions.

New Dimension to Policymaking

Besides having to put up with the cumbersome legislative process, the Executive must contend with the competing interests of traditional elites in Congress. Although pro-administration senators and congressmen have held the majority in both houses, Aquino's reform measures never met easy sailing.

The agrarian reform law is a classic example of reform emasculated by the House of Representatives; landowning members of Congress succeeded in limiting the coverage of the law. Tariff reforms represent another example. The President first tried to enact the reforms through an executive order to avoid delay, but then had to backtrack in face of strong opposition from Congress and big business lobbies.

There have been clashes between the Legislative and the Executive branches also over the appointing power of the President, wage fixing, debt service and negotiations with foreign creditors, stabilization measures and, recently, on the treaty on U.S. military bases.

In July 1990, the President attempted to put up a counterforce to the so-called "traditional politicians" by establishing the Kabisig or Linking Arms movement which would be comprised of nontraditional, nongovernment organizations. Although backstopped by local government executives, the movement never lived up to its promise and failed to take off. In fact, it just created a wider wedge between the President and the traditional politicians.

Conflict in Government

The conflicts between the executive and the legislature are reflected in other levels of the polity -- between the executive and interest groups; between the House and Senate; within the executive branch; and among the three branches of government.

The executive and interest groups

The controversy over the tariff reform measure EO 413 is perhaps the case most richly illustrative of reforms torpedoed by stiff opposition from various interest groups, and the relative roles of Congress and the executive. On the very eve that it was to take effect, the President suspended EO 413 owing to strong lobbying by an alliance of big business leaders. Congress, reflecting a greater permeability to strong lobbies, was generally opposed to the measure as well, with a bipartisan objection that legislative prerogative was being preempted. The compromise proposal arrived at was that Congress would be included in the final determination of the shape of the tariff reforms. Even within the executive department, however, there was no complete unanimity on the magnitude, the timing, and even the very idea of the tariff cuts.

It was only after some time that the successor EO 470 could be promulgated. In the meantime key members of Congress needed to be appeased and strong resistance from other departments within the executive department itself had to be overcome. Externally the country's multilateral creditors also put their full weight behind the measures. In the Philippine Chamber of Commerce and Industry (PCCI), an anti-tariff reform bloc formed around import-substituting industrialists. However, pro-reform proponents gradually eroded the former's arguments and persuaded them to agree on the tariff cuts.

Even so, protected industries have been able to maintain barriers. Cars, beer, cigarettes, appliances, shoes, clothing, coffee, corn, coconut oil, sugar and fruit juice will continue to enjoy a 50 percent levy. Textiles will have a 40 percent tariff, paper and newsprint, 30 percent. Effectivity of the cutbacks will also be spread out through five years.

This case illustrates some of the main elements of discordance in policy reforms. On the one hand, executive and legislative differ in their degree of permeability to lobbying, with the latter manifesting greater openness. Second, however, there was also lack of agreement within the executive itself regarding the wisdom of the tariff cuts, and lobbying within the executive itself was also taking place. This projected weakness and indecision externally (an element which would have been lessened under a "strong" executive) provided an opening for both Congress and the external interest groups. Third, pressure from multilateral agencies have played an important role in many of the reform efforts. On the other hand, this could also provoke an internal backlash, since there is a danger the reforms are perceived as being imposed from without, leading to an isolation of the executive as an instrument of external interests.

The House and the Senate

Dissonance has affected policy making not only through the relationship between executive and legislature but within the legislature itself. Differing legislative priorities between the Senate and the House of Representatives account for most of the clash between the two bodies. Anecdotal evidence abounds. Some examples are:

- *Proposed antitrust legislation.* The last session of Congress saw the antitrust bills pending in both houses at the committee level. There had been no public hearings conducted for the purpose of securing the comments and position papers of various groups. In the House of Representatives, there has been a strong perception that the legislation would run counter to the present government policy to encourage the growth of business.

  On the Senate's part, although the bill had been sponsored by senators constituting the majority, it has never been discussed in the committee level for the simple reason that none of the senators bothered to follow up the status of the bill nor has considered the same to be a priority.

  Officials of the DTI were likewise not too keen on the antitrust legislation. They claimed that, aside from the psychological burden it would impose on investments, it would effectively prevent the establishment of necessary industries owing to the additional restrictions. Hence, the department proposed that the antitrust legislation should contain a transitory provision which would, in the first three to five years, limit the application of the bill on monopolies controlled by a few firms while allowing other industries to be temporarily outside the ambit of the law. After the third or fifth year, the antitrust legislation would cover all entities regardless of classification of industry.

- *Bills on patents.* The bills on patents pending in the Senate were deliberated on by the concerned Committee over an extended period. There was a strong lobby especially from the drug manufacturers in the Philippines to prevent the passage of the law.

In the end none of these bills were passed before the close of Congress. It is possible, however, that these or similar bills may be refiled once the new Congress takes over later this year. In a situation like this, consumers should have been able to play a countervailing role. Unfortunately the Philippines is still no exception to the difficulties of organizing strong consumer groups, a consequence of high bargaining costs. The DTI has been trying to promote the development and strengthening of consumer groups. Hopefully, with the passage of the Consumer Code, this objective may be achieved. Another significant trend has been the efforts of nongovernmental organizations to put up stronger consumer advocacy groups.

Within the Executive branch

Internal disputes among members of the cabinet have also been documented, notably on several issues. The issues of debt repudiation and the Letter of Intent (LOI) of 1988 involving NEDA and Finance-Central Bank on opposite sides were only the more publicised (see E.S. de Dios 1988).

In the area of trade and industry policy, less known to the public were the conflicting views on the magnitude and phasing of import liberalization and tariff reforms and the drawing up of the investment priorities plan. Lines were drawn between the NEDA staff and Finance-Central Bank typically on the one side, and Trade and Industry on the other. The DTI has tended to view the established business sector as its constituency and has usually taken a more cautious, if not conservative, stance on most structural adjustment issues. Finance-Central Bank, on the other hand, are on many issues focused on the urgent financing imperatives and keenly aware that these hinge on rapid introduction of reforms required by foreign creditors, both official or commercial. Finally NEDA, which unlike the line agencies lacks a sectoral constituency, has traditionally tended to assume a more ideological or technocratic posture.

In the move towards tariff reforms, for example, Finance in 1990 at first pushed for a drastic and immediate simplification of the tariff rates to only four or five levels, on the ground that this would "prevent technical smuggling". A determination was also made -- later disproved -- that the drastic tariff simplification would yield a net increase in revenues. This simplification was generally opposed by DTI. While NEDA was also in favour of simplification, it doubted the Finance revenue projections on technical grounds. In the end owing to a strong external lobby and weak internal consensus, EO 413 was withdrawn. Congress was included in drawing up the successor EO 470. All throughout, however, there was on and off struggle within the executive between Finance and NEDA (including the Tariff Commission) on the one hand and Trade and Industry on the other regarding the number of tariff levels, the assignment of particular tariff headings, and the envisioned phasing-in of the tariff reforms. Forced to deal with Congress, the executive itself could not put up a common front.

In the matter of the preparation of the IPP, NEDA and Finance in 1991 lobbied within the executive to reduce the number of industries included in the plan, to the extent of threatening to block the release of the IPP. NEDA and Finance also objected to the broad definition of industries which would have given some discretion to the DTI to choose which projects to approve or not. In the end, the compromise was to release the plan but to give NEDA participation in the selection of firms, in effect checking BOI's authority.

Decisionmaking under the Aquino administration seems to be flawed by the evident inability to adhere to a coherent executive agenda. That cyclicity and logrolling are the norm in the legislature should be no surprise. What is unusual is that the same should affect the executive branch. In turn, this inconsistency may be traced, on the one hand, to the apparent weak center in the executive and, on the other hand, to the heterogeneous character of the coalition which placed the current administration in power. Taken together, these two virtually clear the deck for lobbying to take place within the executive branch itself and lead to the dilution of the commitment to reforms.

Litigiousness and the Legal System

Litigiousness has also been a distinct source of difficulty for potential entrants and has provided an opening for particularist interests to affect major national projects or the entry of new market participants. The tradition of easy recourse to the judicial system (and the failure of the latter to inhibit themselves) to resolve purely economic problems is an important influence on the pace of reform. Whether recourse to the courts constitutes an entry barrier or not depends on the incidence of litigation costs. Generally, however, recourse to litigation can be used to obstruct new projects to the benefit of the incumbent. From the angle of rent-seeking by groups, moreover, even if litigation costs are more or less equal, the legal system may be the preferred arena for battles for dominance by certain groups to take place, in lieu of competing through investment or innovation.

The aborted investment project of the LPC is a good illustration (see Box 6.1 for details). The project which involved the establishment of a US$370 million petrochemical complex got embroiled in a controversy which eventually involved all branches of government.

First, the Philippine National Oil Corporation (PNOC) attacked the project since it would put a strategic industry under the monopoly control of foreigners. Second, the BOI got involved in a quarrel with representatives of Bataan over the site of the project. One Bataan congressman filed a case in the Supreme Court to prevent the transfer.

Third, the secretaries of DTI and Department of Finance came under fire over a financing scheme that would effectively give LPC monopoly control over a strategic industry without using its own money. This led to the involvement of several Senate committees.

Finally, the Supreme Court ruled that the BOI exceeded its discretion in allowing the transfer in project site. The bottom line: the LPC decided to abandon the project. Whether by design or not, it was a case of government serving as barrier to foreign investments. Here one should note that the recently enacted FIA itself has been the subject of a court case by the same member of Congress, although the case did not prosper. Under a working party system, of course, it would be highly irregular if a member of the legislature were to challenge a law which the legislature itself had only recently passed. The deeper explanation for this strange mixup of roles is that the party system in the country does not function fully. Rather, as has been noted above, the tradition of individualist politics is unbroken.

Social and Political Structures

The conflicts described give rise to a general impression of a policy drift in the Aquino government. Rightly or wrongly, political commentators tend to cite the relative political inexperience (and consequent dependence on advisers) of the President as the main reason. In consequence, she is hesitant in the use of existing power levers. This has been compounded with the failure to come out with a unifying vision. Says the Davide Commission (1991).

". . . .the fractiousness in government and politics is a price for democracy which often leads to a dilemma. Its essence is openness and accommodation. But without firm institutional moorings and a unifying political vision, this becomes sterile and even destructive, often leading to chaos. The ensuing turmoil in civilian politics is an invitation to military intervention."

The reconvening of Congress signalled the reemergence of the traditional elites. After the local elections in February 1988, traditional local dynasties were established more than ever. Cause-oriented and non-traditional groups which formed part of the Aquino coalition simply declined in significance. The return of traditional politics was to a large extent due to the efforts of Aquino allies, including a presidential relative, to ensure victory in the two elections. Entering into alliances with former members of the KBL and Marcos loyalists, Aquino leaders put together a political construct, the LDP, which supposedly supported the administration's program.

The President, however, was ambivalent about the patronage-oriented LDP and, although it commanded the majority in the House, the executive never used it fully to push a reformist program. The President was similarly ambivalent about other "more principled" political parties supporting her (Liberal Party and PDP-Laban) because she realized their leaders had political agendas of their own. Instead, she preferred to use other groups to push her projects, acting some times through provincial executives and other times through nontraditional groups. Repeatedly, after every coup attempt, she would try to revitalize [illegible] grassroots support. In June 1990, she launched Kabisig as a nontraditional group to counter Congress, although the experiment was not exactly a resounding success. Adding the unreality of this experiment was the fact that many other nongovernmental and people's organizations in the mainstream of development work were not included in the Kabisig and indeed resented political sponsorship of NGOs.

President Aquino's endorsement of a relative newcomer in politics (though not exactly a new face) as candidate for president could be interpreted in the same light, as a reiteration of preference for the nonpolitician. To ensure victory, she is trying to cobble together a new coalition of governors, mayors and Kabisig organizations. Whether she finally succeeds in creating a nontraditional counterweight to traditional politics remains to be seen.

In summary, policy-making under the Aquino administration has been flawed by a lack of appreciation for the complexity of existing social and political forces and institutions and the failure to comprehend that reforms cannot be accomplished in a vacuum. One thing is certain, traditional elites are once more ascendant. The administration ought to have been quick to enlist these groups or institutions or, in the earliest years of her Presidency, to replace them. The succeeding executive will have its task cut out for it to accept these forces as givens under a constitutional democracy and still manage to build coalitions skillfully enough to implement a program of reforms.

Box 6.1: The LPC Project: Government as Barrier to Investments

On January 14, 1988, the BOI approved a US$220 million investment project to establish a petrochemical complex in the Philippines. The primary investor was Taiwan's USI Far East (USIFE) Corp., in partnership with China General Plastics. The venture was called Luzon Petrochemical Corporation (LPC). The proposed complex would have two components: a naphtha cracking facility, which would produce 230,000 metric tons (MT) of ethylene and 115,000 MT of propylene; and downstream plants which would produce 140,000 MT of polyethylene and 115,000 MT of polypropylene. The LPC project was expected to save US$1.4 billion in ten years. In the aftermath of the August 1987 coup, it was heralded as the best proof of investors confidence in the country.

At first, the project proceeded without much fanfare. The complex was proposed to be located in Bataan, in line with Presidential Decree (P.D.) 49 and PD 1803. It planned to use naphtha as stockfeed, which could be provided by the Philippine National Oil Company (PNOC) in its Bataan site. For a short while, it appeared that the country would at last have an indigenous petrochemical industry considered necessary to achieve newly industrializing country (NIC) status.

By the middle of 1989, conditions in the world petroleum markets changed. Naphtha became more expensive. LPC decided to shift to liquified petroleum gas (LPG) as stockfeed, given its cheaper price compared to naphtha. The decision necessitated additional equipment, increasing the project cost to US$370 million, and a change in project site to Batangas where Pilipinas Shell Petroleum Corporation operates an LPG facility.

The change in feedstock seemed to miff the PNOC which then raised the issue of "strategic interests." Should the government allow a private firm, foreign-owned at that, to have full control of a strategic industry? Upon completion of the project, LPC would stand to own the naphtha cracking facility and three of the five downstream processing facilities. Accordingly, it could easily influence pricing of petrochemical products and by-products and control downstream operations. PNOC recommended that the government hold 60 per cent of this facility. Foreign investors could be allowed to hold the remaining 40 per cent, plus total ownership of some of the downstream plants.

The transfer of the site to Batangas was also opposed by two lawmen from Bataan, who have worked for the reduction of taxes on naphtha. They suspected that Shell had pressed for the transfer since it would profit from supplying the LPG feedstock. Despite this objection, the BOI approved the transfer. This led one of the Bataan congressmen to file a case before the Supreme Court and to leave his seat, until the project site would be returned to Bataan.

The suit delayed the project. Although China General Plastics decided to pull out in October 1989, USIFE was determined to push ahead. This appeared to be the case until May 1990 when a former member of the Cabinet who was then chairman of the Philippine National Bank (PNB) and government representative in the Asian Development Bank (ADB) bared the project's financing scheme and laid bare the possibility that Taiwanese investors would control the US$370 million project after paying a minimal amount.

In a two-part article published in all newspapers, the former Cabinet member revealed that LPC would receive a ₱1 billion peso loan from government financing institutions (GFIs), including the PNB, under "behest" of two members of the Cabinet. LPC would have had only ₱20 million in paid-up capital.

The former Cabinet member further asserted that the two government officials had lobbied for a loan from ADB. The ADB would lend US$30 million, US$16.7 million of which would come from a US$50 million earmarked for the Philippines. This would leave local investors with limited access to ADB credit. Finally, he said that LPC made US$20 million in profits by simply availing of a debt-equity conversion scheme and an extended relending credit facility which had been suspended, but opened to them as a special case. The Central Bank also waived the transaction fee normally charged. In simple terms, USIFE would stand to control a strategically critical industry on account of a generous financing package coming from the host country that would spare the investor from spending its own money.

An article in *Far Eastern Economic Review* (Tiglao, April 1990) came out with the following findings which tended to support the charges:

- Of the US$370 million, fully US$251.8 million, or 69%, will come from loans and equity from multilateral institutions (notably US$90 million from the International Finance Corporation and ADB) as well as local investors and banks. A syndicated peso loan worth US$60 million is to be arranged by local banks, including PNB.

- USIFE's equity investment will amount to US$115 million, or 31% of the total project cost, over three years. Actual cash investments, however, will amount to US$85 million at most.

- USIFE will use Central Bank relending and debt-to-equity swap facilities to augment its actual investments and minimize its foreign exchange risks.

The two members of the Cabinet under fire denied their former colleague's charges of lobbying. One of them implied that the latter might have been led by importers of plastic resins to put the project under a bad light. The other, on the other hand, promised that no GFIs would take the lead in the syndicated peso financing and would put only small amounts..

Following this, the legislature got involved. Four Senate committees held hearings: the Economic Affairs Committee and the Blue Ribbon Committee; in the House, the Committee on Trade and Industry and the Committee on Public Accountability. The Economic Affairs Committee recommended that GFIs should confine itself to financing local investments. The Blue Ribbon Committee decided that given the low level of capitalization for the project and the lack of a track record on the part of the USIFE, the ₱1 billion peso loan had the characteristics of a behest loan, and that special privileges had been granted to the project. It recommended censure of everyone involved in granting special treatment to LPC, including the two Cabinet members and the members of the Monetary Board.

In the aftermath, the former Cabinet member who attacked the project was replaced as PNB chairman and ADB representative. PNB decided to back out of the relending and loan syndication. A few months later, both Cabinet men involved out of the Cabinet.

But USIFE held out until November 1990 when the Supreme Court rendered a decision against it. The Court ruled that the complex should remain in Bataan and should use naphtha as feedstock. Given the large incentives granted to the project, the government had the duty to ensure that national interest would be best served; it felt that the original location and stockfeed were best, and were determined before special interests got involved. Dissenting justices opposed the ruling on the grounds that the Supreme Court should not decide business policy.

For USIFE, this was the last straw. The project which would have been the biggest ever foreign investments was dropped. For foreign investors, it reflected the ambivalence of the Philippines on foreign investments and failed to enhance the country's attractiveness as an investment site.

VII ENTRY BARRIERS AND THEIR EFFECTS

IDENTIFICATION OF ENTRY BARRIERS

Broadly speaking, entry barriers may be distinguished according to whether they are (a) policy-induced or (b) structural. To the extent that the structure of the industry itself or lobbying by its participants creates a demand for entry-restricting policy, this analytical distinction becomes weaker. It should also be understood that in the same industry, both policy-induced and structural barriers may exist simultaneously, and through time, the advantage conferred by the former may be transformed into the latter.

Policy-Induced Barriers

The literature survey and the case studies of selected industries (see Volume II) indicate that entry barriers in Philippine industries are generally induced by policy.

Direct restriction of entrants

The most obvious restriction of entry occurs in those instances where the government explicitly limits the number of participants in the industry as a matter of policy. One variant of this is the usual practice of franchising or licensing of utilities, as may be found in shipping, telephone services, energy generation and distribution, and banking.

The rules implemented by the MARINA in the shipping industry are effective tools in regulating entry. The prior-operator rule gives incumbents the first option to provide additional capacity; the protection of investment rule gives the incumbent a maximum of five years to develop the route, during which time others are disallowed from serving that route; under capacity-regulating rules MARINA determines the needed capacity in all routes subject to franchise, and an operator is allowed to expand only up to a maximum of 20 percent of existing capacity.

In telephone services, for seven decades and until recently, long-distance as well as domestic backbone services were monopolized by the PLDT through government franchises under a natural monopoly argument. Recently international gateways were opened to other participants.

The natural monopoly argument is also cited for power generation and distribution. the Napocor still controls these areas of economic activity. Although EO 215 allows the private sector to enter into electric generation, their projects must still undergo approval by Napocor under PD 40.

The banking sector, which has been well-studied, is also a case where official policy restricts entry and expansion of branches and encourages concentration owing to the externalities of possible bank failure and presumed scale-economies in banking. The CB determines where and how many branches may be established and auctions licenses. A moratorium on the giving of commercial bank licenses was imposed by the CB until 1989 and consolidation/merger was encouraged obviously to reduce the number of banks and increase the size of the remaining ones. New investors could only come in by buying the license of a failed bank. In 1991, the CB relaxed the grant of bank branch licenses through auctions but its retention of the concept of "overbanked areas" indicate the intent to restrict entry.

In other contexts, as mentioned in Chapters II and IV, rationalization programs also provide another occasion for restricting entry. In the car industry, since the BOI embarked on the PCMP and later on the CDP, the story of the car industry has been one of continuing government attempts to reduce the number of participants -- to five under the PCMP and to three under the CDP. For the participants, the government provides a number of incentives, such as foreign exchange allocations (under PCMP), lower tariffs on completely knocked down (CKDs) units, parts and accessories, and access to credit.

The government's efforts to restrict entry explicitly are related to an implied presumption that greater competition is deleterious to either: (a) the achievement of scale-economies (e.g. telephone services, car manufacturing, banking, power generation); or (b) may have negative externalities or consequences on public safety (e.g. banking, shipping).

Both arguments, however, are too easily cited and in each case must be demonstrated (e.g. the car industry or banking) and periodically reexamined as technological change in the industry occurs. As example of the latter, one may cite changes in the telephone industry such as the development of cellular phones that weaken the scale economy argument to the extent physical telephone lines are rendered superfluous. Solar cell technology, once it becomes commercially viable, would render power plants inutile and power monopolies redundant.

Secondly, it should be noted that scale economies in themselves do not constitute an occasion for entry-restriction as a matter of public policy to the extent that possible pecuniary losses from price competition are bound to be internalized by the participants.

Finally, the converse of the public safety or externalities argument for entry restriction must be reexamined. In shipping, for example, it is highly questionable whether the safety or efficiency goals are being achieved through greater concentration.

Bureaucratic requirements

Even if there is no policy restricting entry, extensive bureaucratic requirements (i.e., complying with the legal and relevant regulations for registration) could significantly raise the cost of opening a business or expanding the capacity of an existing business, and hence pose an entry barrier. Although this applies to all sizes of firms, the small- and medium-sized firms are particularly hurt because their resources are small relative to the transactions costs of complying with all the necessary requirements. This is clearly seen in the long drawn out and time-consuming legal considerations and procedures from business inception to registration with the pertinent government agencies.

Lack of transparency in bidding procedures can be classified under this type of barrier. For instance, the DOJ recently ruled that the open bidding conducted by the DOTC was void *ab initio* because the winning bidder, Digitel, had no congressional franchise. This ruling was given five months after the bidding was held and after the award was blocked by protests of a losing (fourth-ranked) bidder. A rebidding was ordered. Digitel's recourse was to go to courts and to appeal to the Executive.

A similar case is unclear rules. Power generation can be cited as an example. The BOT law encourages private sector involvement in providing power infrastructure facilities. Despite such entry-easing efforts, the private sector hesitates to go into power generation because Napocor does not reveal its computations of utility avoided costs which serves as the basis for purchase of the power generated. The power monopoly also effectively acts as a regulator itself as it can withhold approval of private sector projects. The BOT law itself might become inutile unless the government tries to iron out kinks in implementation.

The earlier discussion on BOI shows how an implementing agency can subvert the original intent of the law, perhaps inadvertently. The FIA of 1991 which liberalizes the entry of foreign investors can fall into the same situation, given the discretion of the implementing agency, in this case NEDA, in drawing up the Negative Lists and the List of Strategic Industries.

Credit subsidies

Distinct from and in addition to entry-restriction, the selective provision of subsidized credit has also served as an entry barrier. Instances of this discussed in Volume II are polyester fiber, cement manufacturing, and iron and steel. The episode in which this instrument became prevalently used was the 1960s and 1970s, when import-substituting industries were promoted through credit and credit guarantees from government financial institutions such as DBP and PNB.

Credit provision in itself is not an entry barrier. It becomes a barrier, however, when the same terms are not made available to all potential entrants at all times. For example, lending by government institutions may implicitly keep track of capacity, so that subsidized lending to additional entrants stops when the industry is perceived as "full".

In practice, moreover, the provision of subsidized credit in the 1960s and 1970s typically led to overinvestment (examples are the cement industry and the steel industry). Under the Marcos regime, the grant of "behest loans" by the DBP and the PNB to crony capitalists represented an effective entry barrier. These were absolute advantages to the extent such credit (in the face of imperfect capital markets) on the same terms were unavailable to potential competitors and could typically lead to a dominant, if not a monopolistic position on the market.

Another important effect of government financial involvement in the industry has been to render it prone to responding to demands of industries for regulation and restoring "orderly conditions" in the industry. The evolution of the cement and steel industries are a case in point. The government's exposure to these industries led it to protect itself and its investments, leading in the case of cement to regulation to ensure the survival of incumbents, and in the case of steel to government takeovers of existing facilities.

In the case of the "behest loans" by the DBP and the PNB, most of the nonperforming assets were taken over by the government. In addition, to minimize the losses of some of these firms, existing privileges (e.g. protective tariffs and quotas, foreign exchange allocations, fiscal incentives) were extended to them.

The government also had substantial exposure in several banks that failed. Some of these banks actually had negative net worth. Since the government wanted to recoup its investments in these banks, the CB did not give new licenses and instead encouraged investors to buy the failed banks. Because of the restrictive policy on branch banking which prevailed until 1990, some banks found it cheaper and easier to expand their branch network by buying failed banks. This entry barrier resulted in higher concentration in the banking system.

Fiscal Incentives

Similar to credit subsidies, fiscal incentives, conferred selectively, serve as entry barriers by giving absolute cost advantages to firms which obtain them. While government financial institutions serve as the principal conduits for subsidized credit, fiscal incentives are administered chiefly by the BOI. As discussed earlier, the BOI makes industrial choices through the inclusion of selected industries in the IPP. Sumulong (1992) shows that the internal rates of return of firms who manage to avail of the incentives could be as high as 10 to 12 percentage points over what would be achieved without the incentives. This definitely helps them consolidate their market position.

The Omnibus Investments Code, which serves as BOI's mandate, explicitly uses the notion of "measured capacity" as a criterion for deciding whether an industry is still eligible for incentives or not. It is an empirical question, of course, whether in practice the BOI actually uses the measured-capacity concept in deciding whether or not to delist a particular industry. As discussed in the preceding chapter, the grant of incentives seems to be attended by some arbitrariness.

Import restrictions and tariffs

Import restrictions and tariffs by themselves are not entry barriers, since they may well exist in both contestable and noncontestable markets. The literature on tariff and nontariff protection is already well-developed to bear repeating. However, import protection may serve to reinforce a prior existing dominant or monopolistic position and may sustain an incumbent despite its inefficiency. Documented instances of this occurring are to be found in the steel industry, automobiles, flour milling, pulp and paper, home appliances, among many others.

In steel, for example, the viability and dominant position of the sole producer, which was also government-owned, was secured through import restrictions until 1988. Another example is the pulp and paper industry, where the dominant producer was shielded from imports of newsprint through nontariff protection. Similarly, the position of the participants in the CDP is secured through the high tariffs imposed on CBUs relative to those applied on CKD units, i.e. 50 percent as against 20 percent. Alternatively, advantage may be conferred through the availability of imported inputs at preferential rates, or through the grant of privileges to import inputs or substitutes to the incumbents themselves.

In the flat glass industry, the sole domestic producer has been operating efficiently, yet import protection was accorded to it. The protection has allowed the firm to price its product above competitive levels. The extra profits it realized for several years helped it consolidate its market power.

Import protection often serves as an impediment to structural change. Industries that have been protected for long period of time have benefitted from it and are likely to resist any effort to remove such benefits from them.

While import protection leads to misallocation of resources and discourages potential entrants, trade liberalization does not necessarily lead to improvement in resource allocation and competition. It is highly probable that the dominant domestic producers also become the dominant wholesale importers once trade is liberalized and capture the tariff that has been dismantled by the trade liberalization (i.e., the case of tariff privatization). The case of the flat glass industry could be cited as an example here. The case of the livestock industry is another example. Despite the deregulated trade in feeder cattle, imports have been much lower than the announced quota, and as a result, domestic beef prices continued to rise faster than the world price. Since domestic producers are the dominant importers, they have an inherent incentive to restrict supply of imported feeder stock (Cabanilla 1991).

The comparison of domestic wholesale price (Pd) and the Hongkong unit import value (Pb) of liberalized and remaining regulated commodities yields instructive results (Table 7.1 based on L.C. de Dios, 1992). There is no general pattern of declining price ratios after liberalization. For some commodities, price ratios have declined, while for others, they had increased. Still others had fluctuating price ratios. Many of the commodities still have price ratios that are substantially greater than one even after several years of being liberalized.

All this suggests that promoting domestic competition should go beyond trade liberalization.

Price or rate regulation

Price or rate regulation has in certain instances also served the function of setting limit-prices and has served to deter entry and maintain the existing configuration of firms in an industry. This is especially relevant in cases where the existing firms in the industry find difficulty policing themselves and accordingly create a demand for regulation.

An illustrative example is the case of the cement industry which for a long period was characterized by excess capacity with many players. After a brief period of price wars with widespread losses among producers, floor prices were instituted by government in the 1960s which effectively guaranteed the survival of even inefficient incumbents. This was accomplished through the creation of a regulatory authority (earlier the PCIA and later the DTI) with close links to the industry. Later on, although price floors were turned into price ceilings, they continued to serve the same purpose of a price-target for incumbents. When more recently (in the late 1980s), demand began to outstrip combined supply, understandably the enforcement of price-targets became superfluous, and price controls were removed.

Table 7.1
Price Ratios of Some Remaining Regulated Commodities

PSCC		Commodity	Price Ratios * 1985	1986	1987	1988	1989	1990	Tariff Rates 1985	1986	1987	1988
		Liberalized in 1981 to 1984										
025	11 00	eggs duck	1.44	1.44	1.13	1.01	1.20	0.96	50	50	50	50
	12 00	eggs leghorn							50	50	50	50
048	30 01	macaroni							50	50	50	50
	30 03	sotanghon	4.07	3.91	3.81	3.71	3.02	2.57	50	50	50	50
	30 05	misua							50	50	50	50
	41 01	bread	0.81	0.79	1.03	1.14			40	40	40	40
	41 02	soda crackers	1.45	1.29	1.19	1.08	1.19	0.98	40	40	40	40
	42 02	butter cookies	1.56	1.49	1.44	1.88			40	40	40	40
054	59 16	lettuce	0.64	0.47	0.82	0.56	1.13	0.77	50	50	50	50
	59 29	other veg. (okra, squash, upo, pechay, ampalaya, habichuelas, sayote)	0.72	0.79	0.54	0.62	0.63	0.53	50	50	50	50
056	51 08	mixed pickels	10.84	9.59	9.03	7.52	5.13	5.10	50	50	50	50
057	29 03	calamansi	1.22	1.42	1.47	2.23	0.90	5.43	50	50	50	50
058	30 03	guava jelly	2.25	1.76	1.69	2.42	2.34	2.12	50	50	50	50
	51 00	orange concentrate (w/ pineapple juice)	1.14	1.14	1.23	1.18	1.30	0.89	20	20	20	20
	99 08	pineapple slices (w/ fruit cocktail)	1.14	1.35	1.59	1.47	1.56	1.69	50	50	50	50
061	20 00	refined sugar	2.06	1.62	2.07	2.11	1.69	1.47	50	50	50	50
	92 00	syrup	6.34	5.27	4.16	3.76	3.10	2.86	50	50	50	50
072	20 00	ground cocoa	5.09	10.49	5.71	13.70	12.23	8.39	40	40	40	40
	32 00	cocoa butter	2.61	2.42	1.94	2.02	7.58	4.88	40	40	40	40
098	09 09	tonic food drink	0.87	0.82	0.64	0.47	0.54	0.60	20	20	20	20
075	11 01	pepper, red-hot	0.23	0.18	0.17	0.82	1.01	2.17	50	50	50	50
091	41 00	margarine	2.10	2.14	1.93	3.22	2.07	2.00	30	30	30	30
	49 02	shortening	0.47	0.55	0.70	0.64	0.57	0.58	30	30	30	30
098	04 02	catsup							50	50	50	50
	04 03	tomato sauce (includes patis)	2.10	1.94	1.83	1.87	1.72	1.43	50	50	50	50
	04 05	vetsin							50	50	50	50
	04 07	soy sauce	1.20	1.16	1.16	1.27	1.24	1.11	50	50	50	50
									10	10	10	10
278	30 03	table salt	0.70	0.67	0.80	0.87	0.89	1.00	20	20	20	20
522	52 01	sodium hydroxide solid	26.63	31.00	30.45	23.26	19.46	18.57	30	30	30	30
598	13 02	bonding nalcrete; turpentine							20	20	20	20
533	42 19	quick-drying enamel paint	1.54	1.32	1.22	1.30	1.21	1.12	40	40	40	40
554	11 00	laundry soap	1.39	1.47	1.47	1.29	1.60	1.14	50	50	50	50
	13 00	toilet soap	2.00	2.03	2.10	2.40	1.64	2.16	50	50	50	50
	23 00	detergent	2.06	1.73	1.85	1.73	1.98	1.51	30	30	30	30
642	43 00	toilet paper	2.66	2.44	2.46	2.40	2.12	1.76	40	40	40	40
696	06 04	spoon & fork stainless	1.37	1.45	1.33	1.02	1.09	0.81	40	40	40	40
778	11 02	dry cell battery	2.92	3.48	3.09	3.62	2.65	2.68	30	30	30	30
821	11 01	chairs, narra	0.36	0.38	0.63	0.64	0.47	0.46	50	50	50	50
	22 01	mattress, foam rubber	9.11	9.29	10.09	11.64	9.22	6.11	50	50	50	50
	91 09	bed, steel	0.37	0.46	0.45	0.51	0.78	0.81	50	50	50	50
	92 09	dining set	3.65	2.74	3.03	2.32	1.80	1.61	50	50	50	50

Table 7.1
Price Ratios of Some Remaining Regulated Commodities

PSCC		Commodity	Price Ratios * 1985	1986	1987	1988	1989	1990	Tariff Rates 1985	1986	1987	198
831	01 03	clutch bag, plastic	0.74	0.79	1.00	0.94	0.84	0.72	50	50	50	5
	02 02	luggage	2.37	2.12	1.85	1.61	2.05	1.94	50	50	50	5
	02 03	travelling bag	1.31	1.18	1.30	1.38	1.39	1.52	50	50	50	5
843	43 00	shirt, wash & wear	1.01	1.05	1.06	0.76	0.65	0.53	50	50	50	5
	51 00	blouse, cotton	0.56	0.63	0.64	0.76	0.98	0.81	50	50	50	5
844	11 02	undershirts, cotton	1.81	1.85	1.90	1.70	1.69	1.40	50	50	50	5
	22 01	brief, nylon	3.78	3.45	3.28	3.34	2.55	2.71	50	50	50	50
	32 01	panties	2.02	1.90	2.00	1.74	1.57	1.29	50	50	50	50
847	11 02	handkerchief, plain white	3.37	3.85	4.58	6.35	6.08	5.04	50	50	50	50
	22 03	socks, men's nylon	2.60	3.00	2.87	3.09	3.06	2.83	50	50	50	50
851	01 01	slippers, rubber, men's	0.62	0.96	0.85	0.90	0.91	0.59	50	50	50	50
	02 06	rubber shoes	3.38	3.74	4.44	5.07	5.40	4.96	50	50	50	50
	02 07	canvas shoes	4.76	6.12	7.92	7.78	7.39	6.01	50	50	50	50
898	11 01	piano, upright	0.89	0.81	0.84	0.79	1.02	1.04	50	50	50	50
	32 01	phono record, 45 rpm	0.29	0.25	0.24	0.25	0.23	0.45	50	50	50	50
899	31 00	candles	2.48	3.19	3.22	2.89	3.15	3.16	50	50	50	50
	32 00	matches	4.79	3.26	4.41	4.37	3.00	3.08	30	30	30	30
	72 23	toothbrush, nylon	1.56	1.78	1.79	1.42	1.33	1.22	40	40	40	40
	83 03	buttons, plastic	9.36	8.17	9.07	5.04	3.88		50	50	50	50
		Liberalized in 1985										
022	30 00	fresh milk	1.56	1.29	1.21	1.07	1.02	0.78	5	10	10	10
	43 02	powdered milk	1.30	1.30	1.37	1.36	1.31	1.22	5	20	20	20
	49 04	evap. filled milk	1.51	1.39	1.32	1.25	1.30	1.24	5	20	20	20
	49 08	sweet cond. filled milk	1.20	1.14	1.14	1.16	1.27	1.17	5	20	20	20
023	03 00	butter	2.26	2.18	2.28	2.15	1.85	1.64	30	30	30	30
024	01 00	cheddar chesse	1.19	0.98	0.98	0.96	1.02	1.01	40	40	40	40
057	95 01	pineapple	0.65	0.63	0.86	0.76	1.06	1.09	50	50	50	50
245	01 00	charcoal, wood bondoc	0.64	0.61	0.61	0.57			10	10	10	10
		Liberalized in 1986										
001	41 01	chicken broiler liveweight	1.31	1.14	1.20	1.20	1.16	1.15	50	40	40	40
034	12 00	fish (galunggong, tamban, sapsap, dilis,	0.34	0.31	0.36	0.36	0.47	0.46	50	20	20	30
		dalagang bukid, talakitok)							5	10	10	
035	03 09	dried/salted fish	0.53	0.50	0.36	0.33	0.25	0.36	50	50	50	50
044	01 00	yellow corn grain	2.00	1.90	2.07	1.67	1.62	1.84	50	20	20	20
046	01 00	wheat flour	1.90	1.95	2.04	1.77	1.67	1.62	30	30	30	30
054	40 00	tomatoes	0.65	0.54	0.53	0.74	0.50	0.82	50	50	50	50
057	31 00	bananas	0.44	0.47	0.50	0.67	0.74	0.75	50	50	50	50
	72 00	desiccated coconut	1.22	1.64	1.32	1.18	1.29	1.11	50	50	50	50
	97 01	avocado	0.22	0.15	0.27	0.16	0.19	0.11	50	50	50	50
	97 03	mango	1.08	1.02	0.92	1.24	1.17	1.57	50	50	50	50
	98 05	papaya	0.32	0.33	0.37	0.41	0.22	0.20	50	50	50	50
	98 01	chico (includes caimito)	0.41	0.31	0.31	0.35	0.35	0.32	50	50	50	50
	98 07	watermelon							50	50	50	50

Table 7.1
Price Ratios of Some Remaining Regulated Commodities

PSCC		Commodity	Price Ratios * 1985	1986	1987	1988	1989	1990	Tariff Rates 1985	1986	1987	1988
058	22 08	mango preserves	2.17	3.99	2.97	2.31	1.96	1.62	50	50	50	50
081	21 00	rice bran	1.05	1.45	0.95	0.31	0.76	0.79	10	10	10	10
	99 01	poultry feeds	1.22	0.90	0.96	1.08	1.08	1.06	10	10	10	10
098	07 01	vinegar	1.87	1.76	1.59	1.42	1.46	1.41	50	50	50	50
	09 24	ice cream	0.40	0.37	0.32	0.37	0.33	0.29	50	50	50	50
111	02 05	soft drinks	0.37	0.34	0.44	0.58	0.50	0.42	50	50	50	50
112	30 01	beer	1.00	0.83	0.78	0.92	0.84	0.79	50	50	50	50
	41 00	whisky	2.58	2.13	1.79	1.00	1.44	1.09	50	50	50	50
	49 03	gin	0.38	0.37	0.32	0.30	0.28	0.26	50	50	50	50
	49 04	rum	0.26	0.24	0.26	0.25	0.28	0.29	50	50	50	50
222	20 00	soybeans, local	2.10	1.65	2.29	2.80	1.87	1.80	10	10	10	10
512	18 01	glycerine	1.68	1.93	2.95	3.12	3.31	3.44	50	50	50	50
522	53 01	caustic soda	4.30	4.31	3.86	2.11	1.51	1.40	30	50	50	50
625	10 01	rubber tire, car	1.92	1.82	1.88	1.80	1.51	1.39	30	50	50	30
	20 01	rubber tire, truck	0.78	0.81	0.84	0.83	0.67	0.54	30	50	50	30
657	51 01	rope, abaca	0.98	1.24	0.80	2.45	2.02	2.42	50	50	50	50
658	10 03	rice sack, synthetic (incl. deformed)	0.87	0.91	0.83	0.66	0.74	0.90	50	50	50	50
673	26 00	steel bars, round	1.14	0.95	1.01	0.95	0.96	0.96	20	20	20	20
848	10 03	working gloves, leather	6.32	6.02	5.81	5.49	4.55	4.25	50	50	50	50
898	19 01	guitar, standard	1.07	0.63	0.97	1.32	1.49	1.13	50	50	50	50
899	41 00	umbrella, men's automatic	3.98	4.49	4.72	4.63	4.48	4.02	50	50	50	50
		Liberalized in 1987										
641	21 02	mimeo paper	2.86	2.64	2.08	1.94	1.65	1.56	40	40	40	40
	21 03	bond paper							30	30	30	30
	39 02	kraft–paper	2.11	1.76	1.34	1.29	1.14	1.13	50	50	50	50
642	49 03	adding machine paper	1.28	1.54	1.70	2.44	3.52	3.35	40	40	40	40
651	31											
	32											
	33	yarn, cotton, grey	0.78	0.79	0.64	0.67	0.68	0.74	30	30	30	30
	34											
664	32 00	sheet glass, window	2.07	1.91	1.62	1.41	2.01	3.19	50	50	50	50
	71 00	glass, exec. table top	0.66	0.55	0.52	0.50	0.52	0.53	50	50	50	50
		Liberalized in 1988										
001	31 00	swine, liveweight	2.02	2.28	2.45	2.34	2.42	2.02	10	10	10	10
037	11 04	mackerel (includes tuna chunks)	1.01	0.96	1.00	0.95	0.92	0.82	10	20	20	40
	11 07	sardines							10	20	20	40
122	22 00	cigarettes	0.59	0.56	0.61	0.63	0.58	0.54	50	50	50	50
431	20 00	edible oil, Baguio	0.72	0.60	0.77	0.85	0.79	0.63	50	50	50	50
652	21 01	woven fabric, cotton, grey	2.20	2.16	2.10	2.10	1.70	1.70	40	40	40	40
653	55 02	woven fabrics, rayon	0.50	0.38	0.36	0.35	0.46	0.47	40	40	40	40

Table 7.1
Price Ratios of Some Remaining Regulated Commodities

PSCC		Commodity	Price Ratios * 1985	1986	1987	1988	1989	1990	Tariff Rates 1985	1986	1987	1988
654	40 02	woven fabric, ramie tetoron	3.18	3.30	3.08	2.75	3.12	3.09	40	40	40	40
655	10 00	knitted fabric, nylon	0.46	0.31	0.27	0.28	0.28	0.25	40	40	40	40
	22 00	knitted fabric, cotton	1.19	1.19	1.27	1.29	1.23	1.08	40	40	40	40
812	20 00	porcelain lavatory, water closet	6.22	5.11	4.23	4.36	3.23	3.44	50	50	50	50
									10	10	10	10
874	89 00	voltmeter	1.88	1.53	1.01	5.05	0.53	0.71	20	20	20	20
883	00 00	cinematographic film, neg.	0.57	0.55	0.54	0.51	0.54	0.93				
		Liberalized in 1989										
641	10 00	newsprint	1.71	1.64	1.37	1.11	1.31	1.30	30	30	30	30
661	21 00	cement, Portland	1.56	1.60	1.72	1.71	1.96	2.24	40	40	40	40
		Still Regulated										
001	41 01	chicken, liveweight	1.31	1.14	1.20	1.20	1.16	1.15	50	40	40	40
011	11 00	beef 2nd class	0.84	0.85	0.98	1.02	0.94	0.87	5	20	20	20
	30 00	pork, 2nd class	1.46	1.23	1.33	1.51	1.60	1.39	5	20	20	20
012	11 00	bacon	1.59	1.62	1.67	1.66	1.26	1.04	50	50	50	50
	12 00	ham, cooked	2.14	2.33	2.03	1.41	1.02	1.57	50	50	50	50
014	21 00	frankfurters	2.14	1.93	2.09	2.24	1.78	1.74	50	50	50	50
	22 00	Vienna sausage	2.40	1.86	1.99	2.28	1.30	1.22	50	50	50	50
	93 00	liverspread, potted meat	1.88	1.85	1.99	1.90	1.76	1.82	50	50	50	50
									5	10	10	
034	12 00	fish	0.34	0.31	0.36	0.36	0.47	0.46	50	20	20	30
036	01 09	crabs	0.22	0.18	0.13	0.28	0.18	0.24	50	50	50	50
042	21 02	rice	1.22	0.99	1.10	0.95	1.05	1.06	50	50	50	50
054	11 00	Irish potato	2.36	1.98	1.54	1.61	1.57	1.46	50	50	50	50
	51 01	garlic	5.45	3.32	2.51	8.76	9.41	4.74	50	50	50	50
	51 02	onions, red	2.20	1.69	1.39	2.19	1.66	1.40	50	50	50	50
	59 09	cabbage	0.88	0.85	0.69	0.88	1.04	1.18	50	50	50	50
071	11 02	coffee beans, Excelsa	2.27	1.15	1.59	1.42	1.47	1.24	50	50	50	50
	11 04	coffee beans, Robusta							50	50	50	50
	12 02	ground/instant coffee	3.09	3.14	3.14	5.28	3.17	2.56	50	50	50	50
334	11 02	gasoline ordinary	1.75	1.94	1.89	1.93	1.43	1.51	30	30	30	30
	21 00	kerosene	1.59	1.69	1.66	1.54	1.08	0.94	30	30	30	30
	30 01	fuel oil, bunker	1.41	1.76	1.19	1.42	1.09	1.45	20	20	20	20
	30 02	diesel oil	1.14	1.35	1.20	1.19	0.79	0.84	20	20	20	20
									20	20	20	20
	51 01	lubricating oil	2.10	2.06	2.16	2.24	2.17	2.53	30	30	30	30
341	39 02	LPG	1.62	1.63	1.69	1.46	1.31	1.44	20	20	20	20
511	39 01	freon dichlorofluoro-methane	2.81	2.28	2.36	2.24	1.58	1.16	10	10	10	10
512	18 01	glycerine	1.68	1.93	2.95	3.12	3.31	3.44	50	50	50	50
513	71 02	acetic acid, glacial	3.05	3.58	3.62	3.28	3.55	3.31	10	10	10	10
562	13 00	ammonium sulphate	0.99	0.76	0.75	0.90	0.71	0.76	20	20	20	20

Table 7.1
Price Ratios of Some Remaining Regulated Commodities

PSCC		Commodity	Price Ratios *						Tariff Rates			
			1985	1986	1987	1988	1989	1990	1985	1986	1987	1988
	16 00	wea	1.66	0.85	2.42	0.93	2.00	1.01	20	20	20	20
	19 09	perfect gro	1.00	0.61	0.57	0.66	0.68	0.50	20	20	20	20
591	10 09	insecticide	6.53	5.70	5.82	5.21	4.74	5.60	20	20	20	20
741	52 00	aircon	2.98	2.47	2.53	2.62	2.64	2.50	50	50	50	50
751	12 01	TV set	1.80	1.16	1.24	1.14	1.06	1.22	50	50	50	50
762	22 00	radio receiver, trans.	0.57	0.88	1.05	1.02	0.96	0.88	50	50	50	50
	83 00	radio phono, trans.	0.10	0.15	0.23	1.31	2.34	1.84	50	50	50	50
775	72 02	electric fan	1.74	2.26	2.53	3.52	3.71	3.61	50	50	50	50
778	21 01	electric bulb	1.37	1.39	1.26	0.94	1.09	1.01	40	40	40	40
	22 01	fluorescent tube	11.07	10.26	9.21	8.54	8.25	6.91	10	30	30	30
781	01 00	car, 1800 4cyl CKD	2.36	2.03	1.73	1.81	1.77	1.81	30	30	30	30

Domestic prices over border prices.

_rce: Lorelei de Dios, "A Review of the Remaining Regulated Commodities, PIDS Working Paper (forthcoming).

The same situation is illustrated in the case of interisland shipping, where the regulatory authority MARINA sets freight rates as well as regulates competition.

Under a system of price and rate regulation, the unit price or rate is usually determined by adding a fixed margin to unit cost, reducing the producers' incentive to compete by reducing costs. When profit margin is narrowed by price control, entry incentives are reduced while existing firms find themselves lacking in resources to introduce modernization and technological change. Again, the cement industry may be cited as an example here.

Exit barriers

As pointed out earlier, exit barriers could be a potent entry barrier. If investors find it difficult to shift resources from one economic activity to another, which would involve closing firms, they would be more cautious in entering markets.

Labor and bankruptcy laws are potential exit barriers. Whether these laws at present pose an exit barrier cannot be conclusively shown. There were, however, experiences in the past when the government adopted a policy of not allowing firms, especially those believed to belong to strategic industries, to fail.

The case of banks that failed in the early 1980s could be cited as an example. The bailouts were done through government financial institutions. While these banks were being rehabilitated, the Central Bank maintained its policy of not giving new commercial bank licenses.

In the case of the "promoted" industries (e.g., cement, steel, manmade fiber), the government provided subsidized credit and liberal credit guarantees. When many of those firms collapsed, the policy then was to rehabilitate them to preserve and recoup government's exposure to these firms. Thus, more resources went to these firms instead of using them to facilitate entry by others into more viable industries.

Restricted entry and the trade regime

The implicit goal of restricting entry into certain sectors bears some explanation. In most of the cases examined, it was government policy both to restrict entry and to grant privileges to incumbents. A general rationale for this selective promotion or protection would be that they served the purpose of preventing overinvestment in certain industries.

Quite apart from obvious cases of favoritism and rent seeking, however, restricting entry is sensible to the extent that the industries so promoted and protected would under other circumstances make use of some scarce resource whose social opportunity cost diverged from its cost to private users. Without this divergence, there would be little to justify policies to restrict entry.

For most of the time, this scarce resource was foreign exchange. A regime of currency overvaluation has as its consequence the rationing of access to it, and restricted entry in an industry is one manner of rationing. Unless entry is restricted, the losses from excessive entry or investment in an industry (e.g. through price wars) would have more than private consequences to the extent that the value of the foreign exchange used up would have been greater than as perceived by the users, and the use will have been "excessive". The same argument would hold if the scarce resource were interpreted as subsidized credit and government revenue.

What this discussion suggests is that the policy of restricting entry was merely the converse of a broader regime or ideology of promotion through access to resources at prices divergent from social cost. Where rationing is not necessary, such as where foreign exchange and credit are competitively priced, then the restriction of entry itself becomes superfluous.

Structural Barriers to Entry

Quite apart from barriers initiated by authorities, certain characteristics of industries themselves or actions on the part of incumbents constitute entry barriers. These do not present any large departures from received theory.[1] They consist of scale economies and excess capacity, absolute advantages, high capital requirements and imperfect capital markets, predatory or limit pricing by incumbents, product differentiation and brand loyalty, and incumbent reactions.

Scale economies and excess capacity

Scale economies by themselves do not prevent entry except in so far as there are sunk costs. Without sunk costs, even industries with scale economies may be contestable if the entrant practices "hit and run" tactics. In practice, however, sunk costs loom large in most industries where scale economies exist. This affords the incumbent a first-mover advantage (i.e. apart from other factors such as brand loyalty, etc.), having most of the market. The entrant is confronted with the real possibility that the incumbent can always lower its price when threatened. Since costs must first be sunk before competition is threatened, the entrant may be discouraged from undertaking the investment and risking a price war.

In other words, scale economies make it more credible to the potential entrant that retaliation on the part of the incumbent -- and therefore lower profitability of the entrant's investment -- is likely in the event of threatened entry. The holding of excess capacity has the same effect as scale economies in so far as it affects the conjecture of potential entrants regarding the profitability of competition.

1 Refer to Chapter II for the discussion on theoretical issues which includes Bain's and Porter's classification of entry barriers.

Two instances of excess capacity may be distinguished: in the case of hitherto distressed industries such as cement, the existence of excess capacity is the result of previous overinvestment owing to government encouragement. In such cases, excess capacity is not a strategy of incumbents but an offshoot of government policy. In the cement industry it is estimated that the average cost of producing cement is minimized when plant capacity reaches one million tons of cement. At present, none of the plants have reached this capacity. Expansion plans by incumbents reflect an effort to capture these scale economies. (The majority of the planned plants approach or exceed this capacity.) These incumbent expansions crowd out opportunities for new entrants. Thus, the capacity projections of the Philippine Cement Corporation (Philcemcor) until 1995 ignore the additional capacity of planned entrants registered with the BOI, reflecting the belief that the expansions by the established firms are more than sufficient to meet projected demand.

The other broad case is illustrated usefully by the flat-glass monopoly. The production capacity of RAGC is quite large relative to domestic demand. But it will be able to operate at full capacity at all times, thereby realizing scale economies, since Japan's Asahi Glass Corp. guarantees it will be responsible for exporting any excess supply. Unless it obtains a similar deal from a foreign glass manufacturer, any entrant will have difficulty entering the market. In effect, an entry threat can be met simply by dropping prices. In the meantime, domestic prices for flat glass are kept higher than export prices, indicating market discrimination. The case of glass therefore illustrates a case where scale economies are exploited by the incumbent as a strategy to deter new entry.

Other industries in which scale economies or excess capacity have been observed to deter entry are telecommunications, steel, and paper.

Absolute advantages

There are cost advantages apart from those conferred as a result of policies. The reference here is to those advantages arising from the peculiar nature of the technology employed by incumbents. Examples of these are to be found in telephone services and in flat glass.

Operators wishing to provide toll services must interconnect their facilities with PLDT which owns the domestic backbone system as a monopoly; this enables it to influence the terms and conditions for interconnection and the revenue sharing scheme between inter-exchange carriers (gateway and backbone operators) and local operators. The advantage provided by its monopoly of the domestic backbone service enables PLDT to resist competition in a market that is conceptually distinct: long-distance service. While the government has recently opened international toll services to competition with the grant of franchises and licenses to two other operators, the fact that PLDT domestic subscribers do not have direct access to the competition via their apparatuses severely limits the amount of competition PLDT faces.

In flat glass manufacturing, the tie-up with Asahi Glass Corp. has provided absolute advantage to RAGC. The arrangement guarantees a ready market for RAGC, since all output in excess of domestic production is bought up by Asahi Glass Corp. as exports. Such arrangements are difficult for potential entrants to replicate.

High capital requirements and imperfect capital markets

By itself, large capital requirements is already a formidable barrier to many entrants. That financial markets are imperfect in the Philippines heightens this particular structural barriers to entry. Financial markets are highly segmented and access to their facilities are quite difficult. Capital intensiveness limits the number of entrants in, say, telephone services. Aside from the huge amounts required for start-up capital and acquisition of equipment, continuous infusions of funds are required in view of rapid advances in technology. Emerging rivals such as Digitel have hurdled this barrier through joint ventures with foreign partners and/ or institutional linkages with an established telecommunications player, the Eastern Telecommunications Philippines Inc. (ETPI). Also because of capital requirements, new entrants in telephone services are likely to come from the ranks of major telecommunications firms.

The case of RAGC is likewise interesting in this regard. It was able to obtain a foreign partner, which, apart from providing new technology and guaranteeing an export market for all its outputs, also guaranteed a loan secured by it from a foreign financial institution. Given imperfections in the Philippine capital market, a potential entrant will have difficulty entering the domestic glass market.

High capital requirements become doubly significant when there are imperfect capital markets and credit is rationed. In many instances these requirements were hurdled by the incumbents themselves only through the provision of subsidized credit by the government (see discussion above.)

Most of the industries promoted and granted special credit, fiscal, and protective privileges have been typically capital intensive. It has been repeatedly documented that the investment incentives have a pronounced capital bias. The capital requirements for most of these industries are a large enough hurdle for newcomers, which may typically secure the market for them. Compounding these, however, are the add-on incentives that give the incumbents cost advantages. Other than from government, sources of funds may come from banks with which these corporations have a special connection. The imperfections of the capital market, it may be argued, are one factor in the prevalence of "groups" or conglomerates with their own banks and the practice of extending Director- Officer- Stockholder and Related Interests (DOSRI) loans.

Predatory or limit pricing

It is difficult to prove predatory pricing as a pure strategy on the part of the incumbent. (The case where price or rate regulation serves to set the limit price is treated above.) One example of this is the manner the glass monopoly has dealt with competition from traders supplying competing imports. The domestic firm itself began imports of flat glass, eventually becoming the largest importer. Its familiarity with import prices allowed it to practice limit-pricing on imports, deterring other importers from undercutting it and, in the process protecting domestic production from other-party imports. The same principle may be at work when cement manufacturers are allowed to import cement from abroad.

Product differentiation and brand loyalty

This has not been documented systematically in this study, although the dominant incumbent firms in telephone services and steel are noted to be heavy spenders in advertising. Likewise, players in car assembly, banking, appliance manufacturing, tire making, and to a lesser extent, in cement manufacturing advertise regularly to distinguish their products from those of their rivals and create brand loyalty. On the other hand, incumbents in polyester fiber and flat glass appear to have relatively little need for advertising.

Given the presence of many other policy-induced and structural barriers, it is difficult to determine the relative importance of product differentiation as a barrier. One would expect that this would be a strong barrier in consumer good industries. The first mover expectedly would have strong advantages in this regard, being the first to serve and cover the entire market with its products. Subsequent entrants would have to carefully define their competitive marketing and promotions strategies to win converts.

It could be further speculated that a new entrant who had already surmounted such larger hurdles as scale economies, capital funding, access to distribution channels, and legal requirements (e.g. a franchise) would find overcoming brand loyalty the least of its problems. On the other hand, one could add that the incumbents would likewise attempt to maintain customer loyalty.

The successful penetration of the car market by "people's car" assemblers is a case in point. The lower segment of the market has been underserved for a long time. It did not take much for Kia Pride, Daihatsu Charade and Honda Civic cars to make inroads in a market once dominated by Mitsubishi Lancers, Toyota Corollas and Nissan Sentras. To retain brand loyalty, makers of Mitsubishi and Nissan cars are also planning to go into this segment.

The unsuccessful challenge of Asian Brewery Inc. (ABI) against SMC in the beer market further proves the point. More than ten years after its entry, the former still has about five percent of the beer market. ABI is finding the SMC Pale Pilsen beer drinkers difficult to crack, despite investing heavily in production and distribution, despite coming out with a wide range of beer products, despite pirating top SMC executives, and despite copying the taste and packaging of SMC's flagship product. One reason for SMC's continued dominance is the fact that it has more than matched ABI in product diversification, pricing, and marketing, especially advertising, to preserve its client base. SMC has not been hesitant to pit its entire corporate resources against its challenger.

Incumbent reactions

Although not a barrier class under Bain's or Porter's taxonomy, adverse incumbent reactions can deter entry. This has been seen in telephone services where new entrants experience difficulty in getting interconnections with the domestic backbone of PLDT, or in drawing up revenue sharing arrangements satisfactory to both parties. On the other hand, PLDT's successful efforts to get a franchise allowing it to offer voice and data services could be viewed as a preemptive move to prevent potential entrants from other telecommunication services to encroach into its turf. With the voice-data franchise, it could very well move into the services of its rivals.

The use of the regulatory process or judicial system is usually an action resorted by incumbents in blocking competition (the converse is also true, we hasten to add). One example as seen in the polyester fiber case study is the suit brought about by Filsyn against E-Hsin. The trademark suit of SMC against ABI is another instance.

ASSESSMENT OF EFFECTS

An oligopolistic or even a monopolistic market structure is not necessarily welfare-reducing *per se* (in the sense that it leads to higher prices of commodities than otherwise). If markets are contestable, i.e., entry and exit barriers are absent, and entrants are able to quickly replicate the cost structure of incumbents (Frischtak 1989), then the threat of entry would compel the incumbents to behave like firms in a competitive market structure.

The reality in the Philippines, however, as discussed above, is that there are binding entry barriers in several industries, thus making markets in these industries uncontestable. Many of them have been generated and perpetuated by government policies. This section therefore tries to assess their impacts on the users (i.e., consumers and downstream firms), dominant firms and competitors (actual and potential). Again, our analysis will generally be based on our case studies and on the literature survey.

Users (Consumers and Downstream Firms)

In the majority of the cases examined in this study, there are strong indications of negative effects of entry barriers on users. In the main, domestic user-prices higher than border prices were clearly observed in the car assembly, steel, flat glass, manmade fibers, and cement sectors over long periods.

In polyester, the price of the sole domestic producer has been consistently above the import price inclusive of tariff, except in the last year (**Table** 7.2). The inefficiency in the manmade fiber industry has directly contributed to the poor performance of the country's textile industry which had been required to purchase polyester fiber from the sole domestic producer, and has effectively prevented it from feeding into the more dynamic garments sector. The effects of monopolistic structure on development are more detrimental, the further upstream it occurs, and the penalties and distortions of competitiveness are then likely to be larger. This is aggravated when downstream users are prevented by import barriers from resorting to lower-cost foreign sources for their inputs.

Table 7.2
Comparative Staple Polyester Fiber Prices

	Local Price (₱/kg)	CIF Value U.S. $[a]	Peso Equiv.[b]	Landed Cost Equiv. at 30% Tariff Rate [c]
1980	16.45	1.67	12.54	16.30
1981	20.15	1.76	13.90	18.08
1982	19.11	1.66	14.18	18.43
1983	23.03	1.22	13.56	17.63
1984	41.50	1.25	23.38	30.39
1985	41.99	1.25	23.26	30.24
1986	44.80	1.12	22.84	29.69
1987	40.05	1.18	24.27	31.55
1988	39.58	1.30	27.42	32.91
1989	46.23	1.70	36.95	44.43
1990	33.37	1.27	30.87	37.05

[a] Average price based on data from Foreign Trade Statistics of the Philippines

[b] Conversion to peso equivalent based on average exchange rate for the year

[c] Tariff rate of 30 percent from 1980 to 1987; 20 percent for 1988 to 1990

Source: Board of Investments.

There are cases where the highly protected domestic producer sells in both the domestic and export markets, domestic prices are typically higher than export prices. The flat glass industry serves as an example here. As may be gleaned from **Table 7.3**, domestic prices are double the export prices. The sole domestic producer has a monopoly power in the domestic market but not in the world market. Clearly, domestic consumers have been penalized by discriminatory pricing.

Table 7.3
Comparison of Domestic and Export Price
of Sheet Glass and Figured Glass
In Pesos per Metric Ton

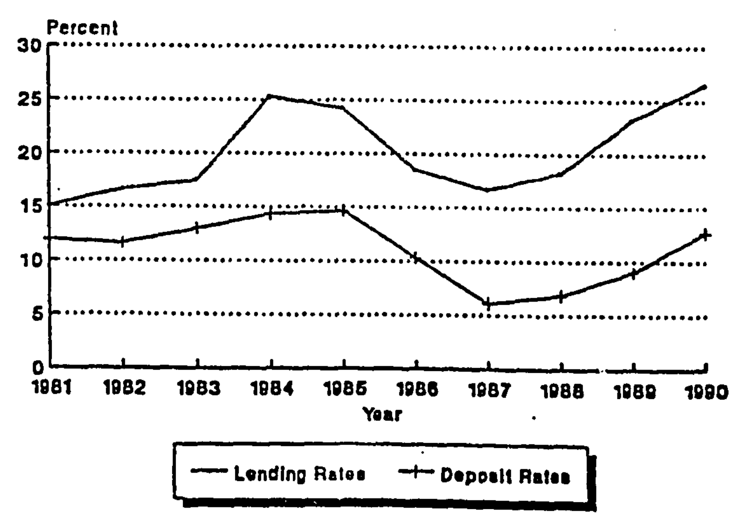
Year	Sheet Glass Domestic	Sheet Glass Export	Figures Glass Domestic	Figures Glass Export
1981	5,663	3,021	4,256	2,982
1982	5,782	3,378	4,466	3,138
1983	6,049	4,164	4,386	3,853
1984	9,323	6,178	6,663	4,909
1985	12,345	5,470	8,690	5,058
1986	12,395	5,686	9,349	4,932
1987	12,419	6,024	9,534	4,585

Source: Board of Investments.

Telephone users, on the other hand, typically complain of inefficient and inadequate telephone system and limited service coverage. Interestingly, international toll rates dropped by 20-40 percent shortly after other competitors obtained franchises for two more international gateways. This points to the fact that toll rates may have been set above competitive levels in the past when only one firm was providing such services.

In the financial markets, interest rate deregulation that was not accompanied by more liberal bank entry and branching resulted in soaring lending rate and a lowering of the deposit rate (Figure 7.1), penalizing both borrowers and savers.

Figure 7.1
LENDING AND DEPOSIT RATES
OF EXPANDED UNIVERSAL BANKS



Source: Central Bank of the Philippines

It was found that both the costs of interisland shipping to the shipping industry and the prices charged to industry's clients are higher than they should be despite MARINA's price regulation.

The common complaints against local car manufacturers are that they produce too little at too high a cost. In cement manufacturing (or, to take another case, flour milling), price controls have not protected the public from rents imposed by sellers during shortages. The recent decontrol of cement prices without a corresponding dismantling of the informal market arrangements raises the possibility that rents may continue to exist during shortages, except that the producers may gain the rents this time.

The typical defense, especially of government-endorsed monopolies, is not to deny that users are being penalized, but to cite higher-order benefits which may be derived from the continuation of the entry barriers. These may range from arguments regarding cross-subsidies (telephone services) to materials security (steel); to positive external economies (car manufacture); to the need to conserve foreign exchange. There is a need in each instance to pin down the argument and compare the alleged source and magnitude of benefits to the costs incurred by the users. Part of the reason the welfare of users has not figured prominently in public discussion is the lack of quantification of opportunity costs.

Dominant Firms and Competitors

Barriers to entry serve to keep inefficient firms operating or, if these firms are efficient, allow them to generate monopoly rents. This is apparent in cement, glass manufacturing, shipping and pulp and paper, among others. The absence or restriction of new entrants served to make incumbents complacent, contented with low profits and unwilling to make innovations or new investments. The cement industry, for example, is known to have been using antiquated machinery; yet, not one among them has availed of the credit program to modernize cement production.

It is likely that monopoly rents have been extracted by the cement industry. This is true at least for the more efficient firms. The pricing strategy has called for preserving even the least efficient incumbent. This works to the benefit of more efficient members of the cartel, who earn rents as a result.

For steel, the monopoly rents generated by import controls have contributed to the rehabilitation of the NSC.

For banks, the policy to encourage merger/consolidation/acquisition has resulted in greater banking concentration and increasing bank spread during the period 1980-1990. The Herfindahl index is found to have a statistically significant effect on bank spread, explaining 65 percent of the variation of the latter.

In glass, steel, and telephone services, dominant firms are observed to have invested and expanded in order to reinforce their positions. For glass and steel, these have also served to deter entry to the extent that excess capacity exists which may easily adjust to fill domestic demand. The technological and financial assistance as well as the special marketing arrangements RAGC has with Asahi Glass Corp. could effectively deter potential competitors from entering the domestic market.

For the dominant incumbent firm in telephone services, continuous modernization programs have served to solidify its position. The move of the regulatory agency to open the sector to competition has not endangered its leadership. However, if the challenge by established firms from related telecommunications sectors takes root, telephone services should improve in the future.

The existing advantages enjoyed by dominant firms may even render policy changes like trade liberalization ineffective. For example, where the dominant producer is itself a trader (e.g. flat glass) it may practice predatory pricing against independent traders, selling imports (but not domestically produced output) at a cost which does not allow a fair profit. One would then observe a gradual reduction in the number of independent traders as well as the amount of imports.

Competitors, potential and actual, have been able to hurdle some of the existing entry barriers, although significant ones remain. In telephone services, international long-distance calls, cellular phones, and consumer apparatuses have been liberalized but the domestic toll backbone monopoly of PLDT -- for which a strong case can be made -- is a lever for resisting the realization of the full gains of the liberalization in other areas.

In steelmaking, the removal of import barriers and the threat of entry of a competitor in primary steelmaking is diluted by the established position NSC has achieved through the years. There are new entrants in the cement industry, but the fact that they enter during a period of excess demand and higher world prices is an inducement not to break the domestic cartel.

As for the car industry, public opinion and lobbying by other manufacturers have led to the opening of the category for cars with smaller engine displacements. It is an open question, however, whether additional entrants are warranted if the aim remains one of exploiting scale economies in the small domestic market.

To the extent that monopoly rents are to be made owing to entry barriers in the domestic market, both incumbents and potential entrants are induced to continue focusing on the capture of those rents, rather than produce for a competitive external market. The fact that large capital requirements are an important entry barrier means that for both incumbents and entrants, the threat of entry is a game for high-stakes (especially where capital markets are imperfect) and will attract many of the important business groups.

This is likely to be an important reason -- not emphasized in the domestic literature -- which exerts a pull on resources away from exports and towards import-substitution.

Government Role

What is evident in these is the continuing large role that government plays -- whether it realizes it or not -- in determining whether entry is warranted and the conditions under which it occurs. The capacity to provide fiscal incentives and trade protection (in earlier periods also subsidized credit) vest the authorities with substantial power in determining when entry is admissible (read profitable). The general pattern seems to conform to the notion of measured capacity.

Government restricts entry and provides other incentives until it deems that domestic (to a lesser extent foreign) demand has expanded sufficiently to warrant a further expansion of capacity, whether this be by incumbents or potential entrants. In effect, it has internalized a good deal of the risks associated with setting up in those selected areas. Much of the estimated costs associated with the system of investment promotion in this country pertain to the revenues foregone. It should be pointed out that an additional social cost is that imposed by the restriction of entry and the industrial configuration it creates.

Finally, the political economy issues must not be disregarded. Government interventions in this country have often given rise to sectors which, when threatened by reforms, often act to protect their interests through stiff resistance and political lobbying.

If owing to its capture, the state itself is predatory, then interventions are expectedly intended to enrich or entrench certain vested interests. But even if the state is democratic or reformist, there is no guarantee that the socio-political environment will permit reforms to be implemented. What is likely is that in a democratic polity, reforms may lead to compromises and half measures, although perhaps not as blatant as in predatory states.

RECAPITULATION

In the main, the conclusion must be that policy-induced barriers to entry have proved more significant than structurally determined ones. Indeed in many cases, the presence of policy intervention has formed the basis for structural barriers to entry such as excess capacity, absolute advantages (through franchises, credit subsidies and fiscal incentives), and limit pricing (via price and rate regulation). In several instances where cartel-like behavior has been observed (flour milling, cement, interisland shipping), the government appears to have a hand in tolerating or abetting collusionary arrangements.

What must be understood, of course, is that government policy to confer privilege and then restrict entry follows from at least two sources. The first is straightforward rent-seeking behavior, as was found for example in the case of many bad loans extended during the Marcos regime in which money was made principally up front. The other, more "sincere" explanation for policy-induced barriers to entry is as an nth-best measure in a regime of repressed prices and rationing. Where important resources such as credit, foreign exchange, or scarce government revenues are not priced at social opportunity cost to the users, restricted entry is required in order to ration them and prevent their dissipation.

Whether indeed the goals accomplished under the promotion programs were achieved sufficiently to justify the initial expenditures remains highly questionable. What is clear, however, is that such a rationale must prove weaker when -- as the government claims -- it is moving towards the pricing of those resources to reflect social marginal cost.

This leads us to the question on how important are the barriers to entry and which type is the most important (read most deleterious). The Study Team has not ventured to answer this issue. While it can be asserted and documented that the barriers have negative effects on the economy, their total impact in terms of losses to the economy is difficult to quantify. At this time, the main indicator of welfare losses is the losses suggested by the difference between domestic and border prices for industries which have been discussed above. It is likewise difficult (perhaps impossible) to isolate the welfare loss impact of each barrier type vis-a-vis the other types.

If the Study Team has to attempt a guess, however, the most important barriers perhaps are fiscal incentives and capital market imperfections which are closely interlinked. Fiscal incentives has a pervasive impact on the economy as it covers over a thousand firms in a wide range of industries. In 1990 alone, 1,510 firms obtained incentives from the BOI, although this number went down to 715 firms in 1991 due to the economic slowdown. Incentives have led to heavy fiscal burdens, with the government losing billions of pesos a year in foregone revenues. Available data show that incentives availment from BOI already reached ₱17.3 billion over the 1978-1985 period (Manasan 1990). Likewise, it has given established firms undue advantages in terms of higher profit cushion.[2] Indirectly, fiscal incentives also affects the direction of the industrial development and can therefore undermine structural changes. Related to this is the barrier posed by capital market imperfections which tend to affect small and medium businesses. It is precisely because of capital resource scarcity that government provides fiscal incentives (or special credit programs) to assist firms. Unfortunately, most firms promoted and granted special credit, fiscal, and protective privileges have been typically capital intensive.

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[2] Higher profit cushion is very important to firms operating in an economy where there is inadequate supply of capital. Larger profits are necessary to finance expansion. This is an opportunity not available to firms that are not accorded fiscal incentives.

VIII AGENDA FOR GREATER COMPETITION

Our case studies, coupled with the review of industry studies, confirm the existence of various forms of barriers to entry in Philippine industries. Most of them have been induced by policy which at times has even reinforced structural barriers to entry. Their negative impact on the economy is significant. They have led to a relatively high concentration in several industries, giving rise to noncompetitive pricing behavior or inadequate services. More importantly, they have undermined the effectiveness of structural reforms being implemented. For instance, even after trade was liberalized, incumbent firms that used to be protected have continued to dominate the industry by also going into trading. Thus, tariff privatization occurred.

Barriers to entry must therefore be addressed by policymakers. We propose the following agenda for policy, research, and technical assistance to enhance competition, in short, a a competition policy to foster a competitive business environment.[1]

ELEMENTS OF A COMPETITION POLICY

The recommendations presented here attempt to outline the elements of a competition policy (Frischtak 1989). On one hand, the proposed reform of the incentives, capacity licensing, public utility, and exit policies deal with the structural dimensions of a competition policy, seeking to remove or lower barriers. On the other hand, the proposed antitrust policy bear on the behavioral dimension of such a competition policy. This is reinforced by institutional reforms, namely the establishment of a central antitrust authority and, relatedly, the overhaul of the bureaucracy. We also propose certain industry-specific reforms and recommendations for private sector activities, and recommendations for public investment programming.

Reforms of General Scope

The Philippines has already introduced substantial policy reforms designed to improve the performance of the economy. Some of these already deal with barriers like import restrictions and tariffs. The thrust toward privatization and reduction of the role of government has led to the dismantling of several monopolies and rationalization programs. The structural adjustment reforms need to be maintained, and any attempt to reverse the market-oriented policies must be resisted. That many of these reforms have been supported by a certain legal framework (e.g. the FIA of 1991, EO 470, etc.) indeed gives some kind of an assurance that they are here to stay at

1 A competitive environment is defined as "one in which efficiency in resource allocation and use is stimulated by domestic competition, import competition between domestic producers and foreign exporters, and export rivalry between domestic exporters and their foreign rivals in international markets" (Frischtak 1989).

least in the medium term. Reform efforts to foster competition should now also be directed at the microeconomic level. The following reforms of general scope are proposed:

Incentives policy

Fiscal incentives and special credit programs have been used to promote certain industries. These have conferred undue advantages to incumbents or to the first few entrants and have limited competition. This is not to mention their negative budgetary implications because of the foregone tax revenues and credit subsidies. As pointed out earlier, we feel that this is the most serious barrier; the first line of attack therefore is to reform the incentives policy.

The focus of the incentives policy should be shifted from promoting certain industries to enhancing competition. Among others, it means reduction, if not withdrawal, of incentives. Given the existing fiscal incentive structure, the following policy measures could be undertaken:

- The existing incentives should be timebound without possibility of extension.
- The incentives should be gradually reduced over time to narrow the difference in the cost structure between the firms which enjoy the incentives and those that do not.
- No new incentives should be given to industries nor should incentives already withdrawn be restored.[2]

In the case of credit programs, there is already a trend towards using these to promote competition and efficient firms. More specifically, the Industry Restructuring Loan of DBP provides loans to industries that are not subject to price control or quantitative restrictions, or do not enjoy excessively high effective rates of protection. The loan program objectives have focused on merely improving firms' access to the capital market instead on promoting certain industries.

Also as stressed before, the barriers posed by fiscal incentives appear to be linked up with financial market imperfections. Hence, related to the reform of incentives policy is the need for further deregulation of the financial markets and foreign exchange. Financial sector liberalization should enhance the efficiency of financial intermediation and help deepen the capital markets.

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[2] As noted in Chapter V, some industries which had been delisted from the IPP have again been listed to accommodate request by incumbents or new entrants. It seems that the decision to list or delist industries in the IPP has become arbitrary.

Capacity licensing and markets

Entry into certain economic activities has been restricted to preserve a balance between supply and demand. In using such consideration, however, demand has been measured relative to the domestic market. The situation could be different, however, if instead the larger international market is being considered.[3] Indeed, capacity licensing is not likely to be needed under that situation. The policy thrust should therefore shift from that of meeting domestic demand to that of achieving international competitiveness.

Interestingly, other objectives of capacity licensing (e.g., achieving scale-economies, ensuring good product quality, etc., not to mention increased employment) can also be met under this competition-oriented policy regime.

An example will help clarify our point. If domestic demand for a particular commodity is 300 units, and if a firm achieves its lowest unit cost at 100 units, then 3 firms are needed to satisfy demand. The industry will have to content itself with an oligopoly. However, if each firm were to export 50 percent of its output, clearly six firms are needed to meet the domestic demand.

The concern for the achievement of scale economies can also be addressed by reformulating our illustration above. If the six firms were to confine themselves to the domestic market, then there is clearly no way by which they can exploit scale economies. It is only when they export that scale economies can indeed be achieved.

Implied in the discussion above is a policy of restricting market access. It has been the policy of the government to push certain firms (as in the case of certain BOI-registered firms) to export all or a part of the output or to prevent them from exporting (formally as in the case of bangus fry, rice and corn or informally as in the case of cement). If international competitiveness were attained, then it would not matter where firms sell their products.

Under a policy regime oriented towards international competitiveness, the content of regulation and promotional programs would be different. Product quality, which has often been denied to domestic consumers, would be given more attention. Programs to gather and disseminate market information could be promoted. It follows therefore that reform of the capacity licensing system should be accompanied by export promotion efforts, including provision of credit and market information, as well as by judicious management of the foreign exchange rate.[4]

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3 The vogue now is to consider dynamic supply-demand equilibrium through a regular review as in the case of the FIA and the 1987 Omnibus Investments Act. Still, it does not consider the international market.

4 Of course, the government should also address business concerns such as energy shortage, high interest costs, infrastructure inadequacy, uncertainties in industrial peace, etc. which reduce the competitiveness of exporters.

Public utility policy

Public utilities present another set of issues. In the Philippine context, the policy thrust has always been to regulate supposedly to prevent excessive monopoly rents and minimize deadweight loss. But what is the recourse when the monopoly supplier is undisciplined or when the market outcome is inefficient?

Experience in telephone services, shipping and power generation suggests the need for greater competition. Public utility regulators should determine the precise scope of scale economies so that they could open up hitherto exclusive preserves to more players.

In telephone services, for instance, the scope of scale economies has been recognized as being limited only to the provision of backbone services. Other services (e.g. long distance, cellular phones, customer apparatuses) are quite distinct and may be opened to competition. Shipping routes should also be open to at least two players in each route. Private sector can now put up their own power generation projects.

Regulators should ease the rules for entry and make them more transparent and operational. If it is not possible to have competition *within* the market, then perhaps the other option is to increase competition *for* the market (Demsetz competition). This implies that in the case where efficiency considerations that indicate only one or a few utility firms can be accomodated by the market, the rights to serve it must be bidded out. A concrete example is the recent bidding for privatization of the government telephone backbone in the north. Unfortunately, the bid has failed and a rebidding has been reordered because of so-called infirmities in the bidding rules.

For similar cases in the future, the regulatory authority must clearly specify the preconditions for the qualifications of bidders. These rules should not be changed when the bidding process is underway and particularly when it is over. Further, the regulator must establish verifiable minimum performance requirements which all bidders for a particular utility must fulfill if they should win, with a clear schedule of penalties (perhaps monetary) in the case of nonfulfillment. The schedule of minimum expansion and investment must be laid out beforehand by the regulators and form part of the pre-conditions for bidding.

Under this policy direction, therefore, the burden is on the regulatory authority to define minimum acceptable terms. This points up the need to strengthen the independent technical capability of bodies regulating public utilities.

Exit policy

Allowing firms freer exit could also lower entry barrier and encourage more competition. There were instances in the past that failing firms were not allowed to fold up because the government either had substantial exposure to them or considered them vital to the economy. In either case, the situation almost always ended up with the government taking over and pumping more money into them to rehabilitate; and the results have been mixed to say the least.

The recently announced policy of the CB not to support weak banks, as it did before, is a step in the right direction. However, other programs of the government seem to go against this trend. The Countryside Loan Fund, for instance, includes a rehabilitation program for those rural banks that failed to qualify in the CB-initiated rehabilitation program. Meanwhile, the government has tried to rehabilitate many of its acquired non-performing assets, hoping to get a better price if they are sold in better shape.

Firms should have a clear signal from government regarding the policy on exit. More specifically, the government should have a strong policy against intervention in nonviable firms, regardless of whether the government, through its financial institutions, has some exposure or not. Rationalization programs, which in the past resulted in an oligopolistic or monopolistic market structure, should be avoided. Instead, inefficient firms should be allowed to fold.

Adoption of a Clearly Defined Antitrust Policy

To addition to the above reforms, the Philippines should aim to thwart anticompetitive behavior and forestall extreme forms of concentration. This points to the need to define and adopt a comprehensive antitrust policy.[5]

An antitrust policy for the Philippines should be suited to the prevailing conditions in the country, which is characterized by an economy highly dependent on international trade, requiring industries to be of size and strength sufficient to compete in the world market. An integrated approach is therefore necessary with respect to all government policies directly or indirectly affecting competition in general and acquisitions of control in particular. This includes policies on foreign trade, foreign investments, industry and structural adjustment, deregulation, privatization, consumer protection, financial market and firm structures.

There is a very strong need for consistency and coherence between such policies and any competition and antitrust law which may be enacted by the State. This need is particularly important with respect to trade policy, where the benefits of international trade liberalization may be reduced by the anticompetitive conduct of dominant firms; in industrial policy, which can promote either large firms or small and medium enterprises; and in deregulation and privatization policies, where it would be necessary to ensure that firms do not take the advantage left by the withdrawal of government, to engage in unfair competition practices.

In order to avoid unnecessary distortion of business decisions, there is also a need to ensure consistency and a degree of neutrality in the application of competition laws towards different types of restrictive business practices, collusive behaviors, existing monopolies, mergers, joint ventures and interlocking shareholdings and directorates, taking into account differences in their effects.

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5 The control of predatory, collusive, entry-deterring and other forms of anticompetitive conduct is what Frischtak (1989) calls the behavioral dimension of a competition policy. Lowering barriers to entry and exit and deterring extreme forms of concentration constitutes its structural dimensions.

While merger/acquisition/consolidation is accommodated by the law, some measures should be taken so that the emerging firm does not acquire substantial market power to deter entry or to keep prices above competitive levels. The antitrust law should be clear on this point. An example could be cited here. In the telecommunications industry, the presently dominant firm already controlling more than 90 percent of the market should not be allowed to buy out other smaller participants or new entrants.

The proposed law should specify its objectives, the practices or arrangements of enterprises that should be prohibited outright or in principle. It should be guided by the concept of contestability. In addition, it should provide for enforcement by the administering or control authority. This should include the procedure to be followed by enterprises in notifying or reporting their activities, contracts, proposals to the authority, as required by the same. The powers of the authority, as well as the sanctions to be imposed on violations should be well-defined. In summary, this antitrust policy should be regarded as a tool to promote competition.

Institutional Reforms

Institution development is a critical component of a competition policy. Our institutional reform proposals include: the establishment of a central antitrust authority and the overhaul of the bureaucracy.

Establishment of a central antitrust authority

Implementation and enforcement of the Philippine antitrust law has been rendered difficult by the absence of a central agency competent enough to evaluate and act upon the state of competition in specific industries. Under the present situation, several agencies are empowered to take cognizance of specific cases falling under their respective jurisdictions as provided by their enabling statutes. This has resulted in duplication and overlapping of efforts. There is neither a system for coordination of efforts between and among these agencies nor do they notify or consult each other formally or informally.

Each office or agency deals with diverse issues such as foreign investments, transfer of technology, planning and programming of domestic industry, import licensing, privatization and government procurement. Under such circumstances, effective action in tracking specific antitrust cases can be overlooked due to the absence of a conscious policy and procedure aimed at controlling and eliminating antitrust activities and restrictive business practices.

Hence, there is an immediate need for the creation of a strong, central antitrust agency tasked with the duty of overseeing the competitive climate in different sectors of the economy within the context of a comprehensive antitrust policy embodied in appropriate legislation.

It is proposed that this central agency assume the functions of the SEC related to the approval of agreements as to mergers, joint ventures and related forms of business concentration. In addition, such agreements shall be periodically monitored. This registration requirement could be an effective and convenient way of obtaining information on restrictive business practices of enterprises. The functions of the Bureau of Patents, Trademarks, and Technology Transfer (Patent Bureau) relative to the registration of licenses and assignments of patent rights must also be transferred to this agency.

A related issue is the institutional arrangements to be undertaken in this regard. There are several options:

- *Create a new entity.* Several variants can be seen in the failed bills. HB 23560 proposes to establish an antitrust commission with visitorial, investigative, and coercive powers; HB 26308, the appointment of an antitrust prosecutor; and SB 996, a Philippine ombudsman on trade, commerce and industry.

  A new body tasked with antitrust functions would have a clearcut mandate that should go a long way to ensure success. Also, responsibility is easily pinpointed when objectives or targets are not met, thus minimizing buckpassing. On the other hand, creation of a new body goes against the spirit and thrust of the recommendation of this study to reduce layers of government bureaucracy (see below). Moreover, this implies fresh outlays from the National Government and add to the fiscal deficits.

- *Create a task force or coordinating committee.* An interagency committee composed of the heads of government agencies which are involved with the promotion of competition or pro-competitive behavior has the advantage of using existing government agencies. Such a body could consist of the DTI as lead agency and the BOI as the secretariat, the NEDA, the SEC, the DOJ, and the Bureau of Customs. A coordinating body should reflect the fact that the antitrust effort involves a number of government agencies that are already in existence, and perhaps what needs to be done is to harness and coordinate their present disparate efforts.

  This proposal does not add to the size of bureaucracy as it only calls for secondment of technical resources of existing agencies to the proposed committee. Such a body, however, lacks continuity in the sense that technical people assigned to it could be pulled out and replaced anytime. Moreover, positive experience shows that personnel seconded to task forces/ coordinating committees often regard their tasks as secondary to their original duties and might not exert full efforts.

- *Charge BOI with the implementation of the country's competition policy, including enforcement of antitrust laws.* The Study Team tends toward this alternative, although the creation of a coordinating body as an interim arrangement prior to the enactment of an antitrust law is not precluded.

A likely candidate to implement the proposed competition policy is the BOI. At present, its role has greatly been diminished with the passage of the FIA, and will be further reduced if the reforms of the incentives and capacity licensing systems are adopted. As its focus will increasingly shift to investments promotion, implementation of a competition policy is an appropriate task for the Board. Investments promotion or, more broadly, industrial development, can be enhanced by promotion of competition, i.e. through removing or lowering barriers or minimizing their negative effects. Further, enforcement of antitrust laws could be put within the context of a competition policy. Controlling or penalizing anticompetitive conduct should ease entry, encourage investments and stimulate industry development.

Once its mission and objectives have been redefined to take on this task of fostering competition, the BOI would need to be overhauled. We anticipate offhand that it should have a strong legal department to be able to carry out its mandate; it is possible that the Board might acquire visitorial, investigative and coercive powers or a quasi-judicial character. The activities of the agency will be guided by a board of directors (governors), which could possibly include representatives from DOJ, NEDA, DTI and the private sector.

It would be necessary to streamline the present personnel complement of BOI and recruit new ones with the necessary expertise. A training program is definitely needed for all the staff of this body. For purposes of coordination and supervision, it may remained attached with the DTI because of the latter's role in promoting trade and industry. This points to a need for institution-building technical assistance to strengthen the capacity of the proposed antitrust/ competition promotion agency to implement, monitor and evaluate its tasks.

Related reforms: overhaul of the bureaucracy

Related to the above institutional reform is the need to overhaul the bureaucracy. This means in general terms an in-depth reassessment of the rationale for regulation and review of the roles of regulatory bodies with the end in view of streamlining and simplifying bureaucratic requirements to do business as well as eliminating excess layers of the bureaucracy. Admittedly, a sweeping overhaul is likely to be drawn-out, particularly since opposition is expected to arise from the civil servants who run the bureaucracy.

Industry-Specific Recommendations

The following reforms are based largely on the results of the case studies. Although the six selected studies may not necessarily represent the entire economy, nevertheless, the industry-specific recommendations may apply to other sectors. They are intended to support the competition policy proposed above.

Telecommunications (telephone services)

Technological advances have drastically changed traditional notions of natural monopoly and have brought about the need to open telecommunications development to greater competition (see discussion above on public utility policy and Demsetz competition). The Study Team therefore sees institution-building as a top policy thrust for the industry, i.e. the strengthening of the regulatory agency so that it becomes technically capable to handle emerging complex issues. Further, to ensure that entry is economically efficient, pricing policies have to be reformed. This will entail deregulating or allowing significant pricing flexibility in market segments which face greater competition.

Manufacture of man-made fibers

We propose to transform the polyester fiber monopoly of Filsyn into a contestable monopoly, in effect forcing it to become a world competitive firm. This is in connection with the plan to include textiles among the 15 groups of products scheduled for tariff reduction under the Common Effective Preferential Tariff (CEPT) designed to set up an ASEAN Free Trade Area (AFTA) within 15 years. Three measures could be adopted in this regard. First, liberalization of imports and tariff cuts must be sustained. Second, fiscal incentives given to Filsyn must be substantially reduced, if not totally eliminated, and manmade fiber altogether taken out from the IPP list. Third, foreign investments must be encouraged in this sector which should neither be included in List C of the regular Negative Lists nor in the List of Strategic Industries.

Glass manufacturing

Government authorities should review the high tariffs on flat glass as the Study Team believes that RAGC does not need protection. RAGC has demonstrated that it can compete in the export markets and that it can handle threats of imports in its domestic turf. We propose to open the sector to international competition; the benefits of such move are obvious. To compete against imports, RAGC will have to lower domestic prices, thereby benefiting end-users. Once domestic prices go down, RAGC might be encouraged to penetrate the export markets. In summary, if the government has to intervene, it should be to infuse competitiveness, not to insulate the incumbents from competition.

Cement manufacturing

The sector has undergone deregulation and liberalization since 1986; this policy trend should be sustained particularly since cement is also slated for inclusion under the CEPT. Consequently, government should no longer tolerate the informal (read collusionary) marketing arrangements within the sector. Relaxation of import restrictions must be sustained. Foreign ownership of cement plants should be liberalized. Lastly, industry should be encouraged to turn increasingly to the export markets to achieve the scale economies needed.

Iron and steel making

Completion of an integrated steel mill appears to be a legitimate policy goal. There are now two contending parties, the NSC and the Jacinto group allied with Chinese interests. Given this backdrop, we propose two complementary measures. One is to immediately initiate the privatization of NSC; this implies the resolution of the legal impediments. The other is to delist the industry from the 1992 list so that new entrants could come in without expecting government incentives and protection. The latter serves as a test that new entrants would come in because of attractive market (domestic and export) opportunities and not because of the higher profitability arising from the incentives. The objective is to put the privatized NSC and new entrants on equal competitive footing. Any first-mover advantages of NSC could be offset by new entrants through technology, organization, market diversification, choice of location, marketing tie-ups with foreign firms, etc.

Manufacture and assembly of motor cars

There is a need to recognize the failure of the CDP. We propose to open the domestic market to competition and let market forces operate more freely. The proposal to open a "luxury car" category is mere tinkering. What the government should do is announce the phaseout of incentives for car manufacturing within two years; imports of CBUs should be freely allowed, but higher domestic taxes on locally assembled and imported units should be imposed for environmental reasons. At the same time, fiscal incentives may continue only for R&D-related activities in the car industry, whether these are undertaken by assemblers of foreign or domestic brands or smaller parts manufacturers. This should have the salutary effects of encouraging innovation and forcing existing as well as potential car manufacturers to produce more efficiently than they do at present. Uncompetitive players will simply wither away while the more efficient ones will remain without significant loss of government revenues.

Recommendations for Private Group Activities

Government intervention to draw up and implement a competition policy that will foster a competitive business environment will have less chances of success without the support of private groups. We have argued earlier that a democratic polity can ill-afford to ignore the political economic aspects of reform. A reformist government needs to enlist the private sector in its push for reforms.

In this light, we propose the following private group activities:

- *Constituency-building.* The government must win support particularly from the beneficiaries (" winners") of its reform program and reckon with the opposition of entrenched groups. The probable winners under the government's reform program could then be tapped for constituency-building among other sectors.

- *Information dissemination.* Given probable political difficulties, the government through its private sector allies must disseminate to the general public the costs of postponing reforms or of inaction and stress the benefits of competition policy reforms.

- *Safety nets.* Constituency-building will also be enhanced by well-designed safety nets to help the vulnerable people. For instance, if the government proceeds with the overhaul of the bureaucracy, programs to compensate and retrain discharged civil servants can be put in place.

Information dissemination, constituency-building and implementation of safety needs can very well be handled by private groups. One such private group particularly for policy advocacy is the Private Investment and Trade Opportunities-Philippines (PITO-P). Donor support could be directed toward these activities.

Recommendation for Public Investment Programming

We anticipate that the reforms proposed above will have certain implications on public investment programming. On one hand, deregulation such as the reform of the incentives should lead to expansion of government revenues. On the other hand, the above reforms call for greater attention in certain concerns such as infrastructure development or power shortage. It is futile calling for the domestic cement sector to look to export markets when production costs are not competitive with those of foreign rivals.

To support the competition policy thrusts, healthier budgetary allocations (that is, arising from savings or increased revenues stemming from the regulatory reforms) should be channeled to infrastructure and energy. Giving the private sector greater access to ODA funds to finance long-gestation projects under the BOT schemes is a step in the right direction. This change, however, should be institutionalized in the public investment programming process.

SEQUENCING, TIMING AND FORM OF REFORMS

Critical to the prescribed competition policy is the phasing and coordination of reforms.

Context and Sequencing of Reforms

Fortuitously, this engagement has come at time when the country is preparing for a change in leadership. By mid-1992, the country will have a new set of national and local leaders. Given this context, we urge the new leadership to adopt the proposed reforms as well as to sustain ongoing stabilization and adjustment reforms. The country can no longer afford any flipflops or populist experiments that will shortcircuit efforts at structural adjustment. We also believe that microeconomic reforms proposed above will have greater chances of success if the new leadership adopts them under a favorable macroeconomic regime.

It has been mentioned repeatedly that macroeconomic reforms have preceded microeconomic reforms, and because of this their effectiveness has been undermined. The trade reform was already cited as an example. Fiscal reform could be mentioned as another example. The effort exerted to increase tax elasticity could be frustrated if fiscal incentives are being continuously extended to preferred economic activities.

Our view is that both macroeconomic and microeconomic reforms should have been implemented simultaneously since each sets a limit to the other. Since microeconomic reforms are now being adopted at a later stage, there is need to focus greater attention on these and accelerate their adoption.

Our proposed sequencing is as follows:

- ***Sustain efforts to stabilize the macroeconomy.*** The reduction of the fiscal deficits and the fight against inflation should be the overriding concerns of the new government. Privatization, enactment of tax measures, and broadening of the tax base take precedence here

- ***Structural adjustment reforms must be continued.*** This means the completion of the tariff reform and import liberalization, deregulation of the labor markets and of the financial markets, and operationalization of such market-friendly laws as the BOT and the FIA laws.

- ***Launch the proposed microeconomic reforms simultaneously.*** Within this favorable macroeconomic environment, we propose the adoption of the elements of competition policy as outlined above.

  - Reforms of the incentives, capacity licensing, public utility and exit policies must be undertaken jointly. Incentive reforms, in particular, should go hand in hand with the liberalization of the financial markets and financial sector reforms (improvement of CB net position) as financial repression might just negate any changes in incentives policy.

  - Reform of the capacity licensing system should be phased with changes in the drawing up of the IPP. We also note the need for export promotion measures to encourage domestic producers to turn to exports.

  - The implications of both the reforms of the incentives and capacity licensing systems on the BOI should be assessed, given the likely diminution of BOI's current activities. On the other hand, institutional arrangements to promote the competition policy might lead to an expansion of BOI's role.

  - Changes in the exit policy should be finetuned with policy changes on entry barriers. This might require a thorough reassessment of related laws within the context of formulating the competition and antitrust policy.

  - Reform of the public utility policy will have to go in hand with the overhaul of the bureaucracy, particularly in the review of the regulatory systems. Streamlining of bureaucratic procedures and systems could trigger this overhaul of the bureaucracy. The formulation of antitrust policy and the design of institutional arrangement should be started.

- The establishment of the institution which will implement the competition policy of the country should complete the first phase of the microeconomic reforms.

Timing and Form

We propose that the new leadership should move quickly. During the very first five days, the new government should announce that it intends to continue with the stabilization and adjustment reforms and to adopt far-ranging regulatory reforms in line with an overall competition policy. The "shock" announcement is intended to send a strong signal that the new government is committed to reforms. Hence, it should immediately announce its economic policy agenda, followed by decisive moves that start to put in place the legal and administrative framework. This is to prevent entrenched interests from consolidating their opposition and countermanding the reforms.

The timetable of further stabilization reforms (the current stabilization program ends December 1992), the remaining macroeconomic reforms and the proposed microeconomic reforms, from review to implementation, should be compressed within a 12-month period. Since the competition policy aims to foster competition and enhance competitiveness, it is optimal to adopt the reform program quickly in order to secure the gains from the improved macroeconomic and microeconomic environment as soon as possible.

Implementation through administrative means

Along the general lines proposed above, whatever could be accomplished through administrative means should be done immediately. Those which would need the act of Congress should also be announced to reflect the committment of the new leadership to reforms. Among the reforms that could be done through administrative means, we propose the following as top priorities:

- *Preparation of the negative lists.* There are two tasks that must be done immediately. First, the preparation of List C of the regular Foreign Investment Negative List (FINL) must be accelerated so that foreign investors would know as early as possible the areas they can enter. The interpretation of the criteria for inclusion in List C must be stringent to ensure a very short negative list. Second, the list of strategic industries, which has raised apprehensions of foreign investors because of the possibility that it could be more restrictive than the present arrangement, must be formulated immediately. To date, NEDA has not yet started fleshing out the criteria for inclusion in the list of specific industries. It is indeed very difficult to interpret in concrete terms the criteria for inclusion in the list of strategic industries embodied in the FIA. Nevertheless, it must be done soon.

- *Preparation of the priorities plan.* By the time the new government takes over in July 1992, the 1992 IPP list will already be in place. It may well be appropriate for the new government to announce that the 1993 IPP list will be much shorter than the 1992 IPP list and immediately start working on it and conduct hearings.

- *Continuing deregulation in key areas.* Some measures to deregulate economic sectors could be undertaken through administrative means. This include the liberalization of bank entry and branching regulation as well as simplification of the process of granting branch bank licenses. Remaining controls on foreign exchange could also be lifted administratively.

  An efficient transport system is vital to enhancing competition domestically. Unfortunately, however, the present transport system is inefficient, which could be largely attributed to regulations that encourage monopolies. Many of these regulations could be changed through administrative means. For example, the DOTC could draft a guideline stipulating that there must be at least two franchise holders servicing any given route. This should be accompanied by price deregulation in shipping. Pricing could be deregulated by allowing operators to charge any rate for first and second class passage rates and by widening the fork tariff range.

- *Simplification of bureaucratic procedures.* Short of a sweeping overhaul of the bureaucracy, certain bureaucratic procedures could already be simplified. SEC's implementation of an "express lane" system to process applications is one such step in the right direction. SEC can now process applications under the FIA in a week's time. However, there is a need to dovetail the requirements of CB (e.g. for the repatriation of profits) and BOI (for incentives) into SEC procedures so that foreign investors would just have to go through a single process that will satisfy requirements of pertinent agencies.

  Efforts to make the BOT law more operational and more responsive to private sector needs is another concrete example. Streamlined procedures translate into a more efficient bureaucracy, which reduces transactions costs and ease entry.

Reforms through legislative actions

Certain aspects of the proposed reforms on incentives, capacity licensing, public utility, and exit would require thorough review of existing laws, and implementation would need act of Congress. What is important, however, is for the new leadership to act decisively in drafting the required bills and certify them as urgent bills.

Along this line, "dead" bills on antitrust law (including establishment of an antitrust body) should be reviewed, redrafted and refiled. Other competition-fostering bills should not be neglected; these include bills on patents, liberalization of entry by foreign banks, liberalization of ASEAN investments, and universalization of the availment of incentives. Preliminary work on these bills had already been done by the present Congress and revised bills on the same subject matters should be refiled immediately in the next Congress.

Political economy of reforms

Lastly, adoption of reforms calls for building of consensus. The new government cannot disregard the existing social and political structures and should anticipate possible resistance of interest groups. As said earlier, it is incumbent on the new government to cultivate support along various economic groups. In short, the government must promote its economic agenda and urge the beneficiaries of the program, i.e. the eventual winners, to acquire ownership to that agenda.

RESEARCH PRIORITIES

In support of the policy agenda for greater competition, the Study Team has pinpointed certain research issues. Arranged according to priority, these areas include:

Urgent Research Issues

We propose that research must immediately focus on the following two areas:

Determination and assessment of strategic industries

The list of strategic industries supposed to be drawn up under the FIA can be a potential barrier to entry. To forestall this from happening, a quick-response study, therefore, needs to be done. The study should start with a review of the concept of strategic industries, perhaps including a description of how such concept has been applied in other countries. Then it will focus on the determination of specific indicators which would serve as the criteria prescribed by the FIA for the inclusion of list of strategic industries. This could be finetuned by applying them and analyzing possible consequences in terms of attracting foreign investments. The results of this study are likely to be extremely useful to NEDA, which has only a year left to formulate the list of strategic industries.

Formulation of an antitrust policy

The formulation of an antitrust policy requires solid basis from research results. The research may be divided into two components: (a) legal aspects and (b) economic aspects.

With respect to the legal aspects, a comparative analysis of the antitrust laws of several countries representing the developed countries, NIES and Less Developed Countries (LDCs) may be done to determine their strengths and weaknesses, and to draw lessons for the Philippines.

Regarding the economic aspects, the present Barriers to Entry study can be viewed as an exploratory attempt to look at barriers to entry in Philippine industries, relying on results of existing studies that either entirely or partly focus on market structure and on the six case industry studies. In terms of coverage, therefore, the study could be broadened. Other sectors and industries could be studied to give a broader picture of the types and effects of barriers to entry on market structure and prices. It is proposed here that industries that have been delisted from the IPP list could be examined to determine whether competition has improved or diminished. This could be contrasted with those industries that have not been in the IPP list.

A model to quantitatively determine the effects of entry barriers on the performance by the industry was presented in Chapter I. Lack of sufficient time series of the relevant variables for specific industries has prevented this study from applying the model. The proposed study should consider doing this, although data availability might again be constraining.

Additionally, a better quantification of the effects of barriers to entry on the welfare of the users (both households and downstream firms) needs to be done to heighten the level of understanding of the market structure-conduct-performance, raise the level of policy debate, and sharpen the thrusts of the proposed antitrust policy.

Other Research Areas

The following research issues could be also addressed, although they are not considered urgent as the two issues identified earlier.

Research areas of general scope

Research areas with wide applicability include:

- *Market contestability.* As pointed out in several sections of this study, market concentration *per se* need not impose social cost if the market is contestable. This requires an in-depth analysis of the contestability of those highly concentrated industries. Findings of this studies could lead to regulatory changes aimed at improving the economic efficiency of these industries. Again, detailed microeconomic data, specifically cost and price structure, are needed. The pay-offs of these studies could be high as demonstrated by Baumol and Lee (1991). Moreover, it could sharpen the application of the proposed antitrust policy.

- *Role of LGUs in enterprise activity regulation and deregulation.* The study has not been able to go in-depth into the role of LGUs in enterprise regulation and deregulation, an issue which might gain greater urgency in the light of the recent passage of the Local Government Code. This is proposed to be done as a separate study, with a high-growth and a low-growth LGU serving as case studies.

- *Exit barriers.* The study has not been able to detect possibilities of certain laws, such as labor and bankruptcy laws, serving as exit barriers for lack of data. This will require gathering data from firms that encountered problems with such laws.

- *Ownership structure.* Aside from quantitative analysis of market concentration, qualitative analysis, say by looking at ownership structure, could render more insights into the dynamics of market concentration. In cement, for example, where there are 18 plants, three family blocs have dominated the industry in terms of number of plants and aggregate rated capacity. Needless to say, three family blocs have substantial market power in the industry. Situations like this could be found in other sectors not covered in this study. The existence of conglomerates or groups whose interests span several industries could also affect the dynamics of competition in a single industry. Studies on this issue have been largely descriptive and classificatory (Doherty 1980), and have not examined their impact on industrial organization and economic performance.

- *Effects of patents as an entry barrier.* A follow-up study can focus on the effects of patents on certain industries like, say, the pharmaceutical industry.

Research areas specific to certain industries

The case studies uncover certain research needs related to the central themes of the study. They are as follows:

- *Telecommunications (telephone services).* Given the failed bidding for the privatization of the government telephone systems in the north, an assessment of the bidding/privatization guidelines the controversy that arose, and the resolution of the issues may be undertaken as a case study to determine lessons learned and propose corrective measures that will facilitate competitive entry into the market. Further, in-depth study of the effects of barriers can be extended to the telecommunications industry as a whole (that is, not limited to telephone services). Thirdly, a study to determine market segments which should be opened up to greater competition should be helpful to policymakers.

- *Manufacture of man-made fibers.* We propose an update of the Mercado (1987) study (see literature survey in Part I of Volume II) since there have been recent changes in policy developments such as reduction in the tariffs on imported polyester products. Estimates on the domestic resource cost are important to assess the comparative advantage of the industry. The study of barriers on man-made fibers could be extended to the downstream industries (garments).

- *Glass manufacturing.* One pressing need is an empirical study of rampant misdeclaration of imports under the import liberalization program and the ASEAN margin of preferences. This should be verfied so that corrective measures could be installed. A study of trade policies of countries with potential markets for flat glass should also be valuable to policymakers and the incumbent.

- *Cement manufacturing.* It may now be worthwhile to measure the consumer welfare loss due to rents related to entry barriers. Such a quantification strengthens the arguments for reforms and reinforce the political will to pass such reforms. Secondly, the dynamics of family group competition (Phinma, Zobel-Araneta, Alcantara, E. Cojuangco, etc.) within the sector is an interesting research topic.

- *Iron and steel making.* Two important issues need to be closely examined. One is an impact assessment of import liberalization on NSC. The other is to review country experiences on the establishment of a fully integrated steel mill.

- *Manufacture and assembly of motor cars.* Given our proposal to open the car industry to greater competition, one research area is an assessment of the fiscal and employment implications of the move to phaseout incentives and allow imports of CBUs. Likewise, a study of successful country experiences in setting up a domestic car industry may also be included in the research agenda.

TECHNICAL ASSISTANCE

Technical assistance could be directed to several areas.

- *Program in support of the competition policy studies.* One area for technical assistance is to support the conduct of research studies suggested above. A program approach (which could be called "Support for Competition Policy Initiatives") is preferred over a project approach. There might be, however, an urgency for some of the issues, particularly the list of strategic industries and design of antitrust policy.

- *Institution development.* The second area is to support institutional development. It has been suggested above to assess the options on institutional arrangement to implement and enforce the proposed competition policy, including the antitrust law, and determine the best alternative. Depending on the type of arrangement chosen, the implied (re)organization may be more or less substantial. Technical assistance could be directed toward such an organization study (this is timely at the moment since there are moves to reorganize SEC and BOI).

  Technical assistance could go beyond the organization study to the initial phases of setting up of the institution and training of people. Personnel to staff the proposed antitrust body will have to undergo training. This can take the form of sending key personnel to other countries with long and successful experience in prosecuting antitrust law.

- *Overhaul of the bureaucracy.* Also along this line, technical assistance could be offered in relation to the proposed overhaul of the bureauracy. This means review and simplification of the regulatory and supervisory responsibilities of government agencies. This can include not only national government agencies but also the LGUs.
- *Donor support for private sector activities.* Lastly, donor support could be given in relation to private sector activities relevant to the implementation of the competition policy. These are in the areas of information dissemination, constituency building, and implementation of safety nets.

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BARRIERS TO ENTRY STUDY

April 1992

FINAL REPORT

VOLUME II

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PREFACE

This study examines the types and effects of entry barriers in the Philippines. The United States Agency for International Development (USAID) has commissioned SGV Consulting to undertake the study in order to develop background information on entry barriers in the country, and propose policy recommendations that will help remove these barriers or minimize their negative effects.

The SGV Consulting Study Team consisted of the following:

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April 1992

BARRIERS TO ENTRY

VOLUME II

Part I : SURVEY OF PHILIPPINE LITERATURE

Part II : CASE STUDIES

Telecommunications (Telephone Services)

Manufacture of Man-Made Fibers

Glass Manufacturing

Cement Manufacturing

Iron and Steel Making

Manufacture and Assembly of Motor Cars

Part I

SURVEY OF PHILIPPINE LITERATURE

SURVEY OF PHILIPPINE LITERATURE

TABLE OF CONTENTS

SURVEY OF PHILIPPINE LITERATURE

OVERVIEW

The literature survey reveals that research in the field of industrial organization in the Philippines is relatively undeveloped. Theoretical and empirical works on industrial organizations in the tradition of the structure - conduct - performance paradigm (SCPP) are limited.

Industry studies generated by SGV & Co., the Center for Research and Communications (CRC) and the Private Development Corporation of the Philippines (PDCP) are largely business-oriented rather than policy-oriented. These include feasibility studies, market studies, corporate strategy studies, investment opportunity studies, and similar types of this genre. Invariably, these types of studies provide information for the business manager and so focus on financial projections, market potential evaluation, plant capacity and raw materials planning, and economic feasibility analysis.

The same observation could be made of research works and graduate theses at the University of the Philippines (UP) College of Business Administration and at the Asian Institute of Management (AIM). In the UP College of Business Administration, only three studies are related to the central themes of this study.

At AIM, however, it is striking to note that Porter's works appear to have a strong influence on graduate students. A number of AIM theses over the 1985-1991 period uses the Five Forces Model as the framework for industry structure analysis, discussing the entry barriers of specific industries to some extent.[1] Unfortunately, the Five Forces Model gives rise to problems of measurement and interpretation. Discussion in the AIM theses, consequently, does not attempt to go deeper than an impressionistic, descriptive analysis. Entry barriers are often treated in general terms, presented only to draw out the potential effects on the specific firms and to serve as parameters for formulating corporate strategies. Typical of this is the Ignacio thesis (1989) on electric power supply which is reviewed below.

Research work at both the U.P. School of Economics (UPSE) and the Philippine Institute of Development Studies (PIDS) tends to focus on macroeconomic policy issues, specifically in the fields of financial markets and banking, trade and tariffs, fiscal matters and investments, and agriculture and health care. UPSE and PIDS advocate the need for liberalization and deregulation measures, and their analyses of the policy environment in this regard are useful to this engagement.

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[1] See Volume I for a discussion of Porter's Five Forces Model. Examples of AIM theses where the model has been applied include: electrical power (Ignacio, 1989); appliance manufacturing (Batuhan, 1991); financial services (Casares, 1991; Torres, 1991; De la Rosa, 1986); transportation (Chan, 1990); water supply (Estreta, 1990); chemicals (Flores, 1989); customs brokerage (Gelano; 1991); garments (Purificacion, 1991); firearms manufacturing (Sembrano, 1991); construction (Sua, 1986); pulp and paper (Tolentino, 1988); and publishing (Valdez, 1988).

In 1986, the Tariff Commission (TC) and the PIDS undertook a joint research project to assess the effects of tariff changes and import liberalization on certain industries. The TC-PIDS Joint Research Project uses Effective Protection Rates (EPRs) as a measure of protection and Domestic Resource Costs (DRCs) as a measure of comparative advantage.[2] Their studies on home appliances, textiles and tire manufacturing are cited below as they offer some explanation for industry concentration.

Several studies commissioned or prepared by multilateral and bilateral agencies (e.g. World Bank, USAID, Asian Development Bank, etc.) cover Philippine industry or specific sectors. Again, the focus is on industrial development, regulatory and policy issues. These studies generally articulate the urgency for reforms, some of which are discussed below.

It has become increasingly necessary to consider the political economy of reforms. The ascent of a more democratic administration has not made adoption of reforms less difficult. On the contrary, the reemergence of the Legislative as a coequal branch of the Executive has resulted in policy deadlocks. Likewise, special groups whose vested interests are threatened by reforms have not been averse to using their political power to block reforms. Structural adjustment must tackle the political roots of economic distortions and consider not only the form and sequencing of reforms but also the institutions that will implement these. Given this concern, a survey of political economy literature is included.

The literature review is limited to studies that are related to the central issues on barriers to entry and provide certain indications of market structure, conduct and performance. These are categorized into: (a) those that examine the Philippine economy, industry or the manufacturing sector as a whole; (b) those that deal with a particular subsector; and (c) studies on the political economy. In summary, stylized facts on Philippine industrial structures have been derived from the survey.

INTER-INDUSTRY STUDIES

Measures of Concentration

Lindsey (1977, 1978) is the very first to do a rigorous analysis on entry barriers in the Philippine context. Lindsey examines the level of concentration in the manufacturing sector, its determinants, and its relationship to industry performance or profitability. The determinants of the level of concentration provide some insights into the types of barriers to entry confronting the manufacturing sector.

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[2] The EPR is defined as the percentage excess of domestic value added at protected prices (arising from tariffs, taxes and import restrictions) over value added at free-trade prices (without protection). A positive EPR tends to show that the industrial activity is protected while a negative EPR implies that the activity is not conferred with incentives but penalized. The DRC, on the other hand, indicates the value of domestic resources in shadow prices, used per unit of foreign exchange earned or saved from the production of a tradeable good. When compared with the shadow price of foreign exchange (SER). See Mercado (1987).

Lindsey's first article (1977) analyzes the concentration ratios in the manufacturing sector 1970, using two-digit International Standard Industry Classification (ISIC) level of aggregation. The concentration ratios are measured in terms of value added and employment with the former having greater relevance than the latter because ". . . . larger plants, as a rule, will use larger, more modern technology which requires relatively less labor." Lindsey finds high concentration ratios, suggesting that the manufacturing sector of the Philippine economy could be characterized as oligopolistic.

Lindsey tests the hypothesis that the size of the industry, degree of capital intensity, efficient plant size, growth rate of industry, degree of fabrication, and the proportion of the market supplied by imports or import ratio are correlated to the level of establishment concentration.

He opines that capital intensity is an important barrier to entry in a third world economy where labor is relatively cheap and capital scarce. New entrants needing to put up large initial outlays of capital must pay dearly for scarce capital. The minimum efficient size of plant can also serve as a barrier to entry since the higher the minimum efficient size, the greater the capital requirement.

Another barrier to entry is the degree of fabrication, which is measured in terms of value added per worker. In particular, "entry would be more difficult due to the increased amount of finance needed, knowledge of production processes, and appropriate skills" when the industry is engaged in several processes of production yielding higher value added.

Finally, the import ratio, which is the ratio of imports including duties and other charges, to revenue from domestic production plus imports, could be a measure of the crowding out by imports of entry opportunities of potential domestic producers.

Except for the import ratio, all the determinants are found to have a statistically significant correlation with the level of concentration. However, the coefficient of capital intensity yielded a perverse sign. Lindsey thought that widespread excess capacity prevailing in the Philippine manufacturing sector could help explain that unexpected result.

The last hypothesis that Lindsey tested in this paper was that the higher level of concentration leads to monopoly power. The latter is measured in terms of the price-cost margin, which is defined as the ratio of value added minus payrolls to the value of goods produced in a two-digit industry. His finding supports the hypothesis.

Lindsey's subsequent article (1978) examines the changes in market concentration in Philippine manufacturing between 1960 and 1970. The determinants are the same as those in his previous article, except that the 1960 level of concentration is added as a determinant of the 1970 concentration levels to test the hypothesis that highly concentrated industries can invite more new entrants that bring down the market share of the leading firms.

Expectedly, Lindsey finds that for the period under study, the change in establishment concentration is negatively associated with the initial level of concentration, i.e., those initially highly concentrated industries experienced falling concentration ratios. This can be the "result of the attractiveness of highly concentrated industries, with their high profits, to new producers."

The other determinants of the change in establishment concentration have the same statistical effect as in his previous article. Also, the evidence showed that changing concentration is associated with the degree of monopoly power within an industry.

Patalinghug (1983) tries to improve on Lindsey's measure of establishment concentration by using four-digit ISIC level of aggregation. He studied only three sub-sectors namely food, home appliance, and textiles. Patalinghug finds much higher concentration ratios, which is to be expected given the finer level of aggregation. Accordingly, the four-digit level of aggregation is the appropriate economic concept of an industry. However, he does not go further to test some hypotheses as what Lindsey did.

Measures of Protection

E.S. de Dios (1986) notes that the "empirical material dealing with the degree of industrial concentration and the degree of protection in the Philippines exists mostly as largely separate bodies of literature."

E.S. de Dios tests the hypothesis that tariff protection is correlated with the industrial structure. As a measure of monopoly power, he uses the three-establishment value-added concentration ratio for 1970 and 1979, both from the National Census and Statistics Office's Annual Survey of Establishments. Industry protection is measured by the 1974 (EPR) representing both years since there are no substantial changes in the protection structure in the interim.

Some explanatory variables are added, which E.S. de Dios says might represent barriers to entry, viz., the degree of capital intensity represented by the capital-labor ratio, value-added per employee which is related to minimum efficient scale, and value added per worker which is related to working capital requirements. This is largely similar to Lindsey (1977, 1978). His results show that the EPR and the three variables representing barriers to entry have a significant, positive effect on concentration.[3] This result holds true for both the 1970 and 1979 data sets.

Further testing whether levels of concentration are associated with levels of industrial or firm profitability, he regresses the variable price-cost margin of the top three firms on value-added concentration ratio and capital-employment ratio.[4] His results suggest that establishment-concentration permits the earning of monopolistic profits.

The third hypothesis tested by E.S. de Dios is whether the pattern of investment of concentration of foreign investments is determined by the opportunities for monopolistic advantage. His empirical result again supports the hypothesis.

While E.S. de Dios (1986) examines the effects of tariff measures on industrial structure, L.C. de Dios (1987) studies the relationship between non-tariff measures (NTMs) and industrial concentration. She uses the three-firm value added concentration ratios for 1983 and the NTM which is measured by the value of 1979 imports affected by licensing requirements. The results suggest a strong correlation between the two variables.

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[3] The three variables representing barriers to entry were however highly correlated. So, he ran regressions including those variables one at a time.

[4] The price-cost margin was obtained by summing up census value-added for the three firms, subtracting employees' compensation, then dividing by gross output for these firms.

Observations

Several observations can be made about the studies discussed above:

- The studies do not seem to accommodate possibilities for the existence of economies of scale. It is possible that some of the industries are still in the process of realizing economies of scale, hence concentration is likely to occur.

- There is no sufficient attention given to the fact that some industries had just started to emerge in the economy. In such a case, even if there are no effective barriers to entry, potential entrants may be willing to postpone their entry until after the experience of incumbents has been observed.

- The price-cost margin which is used as indicator of the monopoly power may not be appropriate since various industries would likely have different price-cost margins. It should be noted that the empirical studies done by Lindsey and E.S. de Dios were done using two-digit International Standard Industrial Classification (ISIC) level of aggregation. The products produced by firms within each industry classification could be widely diverse and not substitutable. Implied in this is that they could be operating in different markets and using substantially different technology.

- The contribution of policy to the creation of monopoly power was not sufficiently treated in the studies, given the restrictiveness of economic policy in this country, especially in the previous administration, and the fact that the government did try to promote certain industries with preferential polices. E.S. de Dios partly treated this when he explicitly included EPR as a determinant of the level of value added concentration. But other policies, especially incentives policies, could have contributed much more to concentration. And this could have been reinforced by the wide discretionary power given of regulatory agencies.

SUB-SECTOR STUDIES

Below is a review of several sectoral studies that, to some extent, includes an analysis of entry barriers and illustrates market and regulatory structures within the sectors.

Banking

Banking is heavily regulated. This is understandable since the business of banking is not similar to producing and selling toothpaste. The failure of a toothpaste company may be applauded by the remaining competitors. In contrast, the failure of a particular bank may result in a widespread run, thereby pulling down all the remaining ones. Thus, while competition is being promoted, the stability of the entire financial system must be also ensured.

After the establishment of the Central Bank, no new foreign banks had been allowed to enter the domestic financial market. Instead, the Central Bank encouraged the establishment of domestic commercial banks. Thus, from the 1950s to the 1960s, domestic banks had proliferated. Rural banks were also promoted and protected. Specifically, only one rural bank was allowed to operate per town. The failure of several banks in the 1960s prompted the Central Bank to declare a moratorium on new bank licenses (Lamberte, 1989).

Among the 1972 reforms inspired by the IMF was a decision to favor bank branching over new entrants. But the requirements to open a branch were very restrictive and the basis used by the Central Bank in allowing branches to be open in certain localities was dubious (Lamberte and Lim, 1987). Foreign investors were allowed to own up to 40 percent of the outstanding shares of existing domestic banks.

In the 1980 financial reforms, banks were encouraged to merge and consolidate to exploit economies of scale and scope. Thus, the existence of a barrier to entry had been justified on the basis that there were still scale economies in banking not being exploited by existing banks, most of which were small. Lamberte (1982), however, finds that to the contrary majority of banks had either completely or nearly exhausted the economies of scale. He therefore questions the merit of the policy encouraging the expansion of the size of existing banks through internal capital build-up and/or merger. Implied in this is the need to liberalize bank entry. Despite this, the policy of reducing the number of banks through merger and consolidation had been continued. Thus, no new commercial bank had been established between 1980 and 1988 (Tan 1989).

The impact of the restrictive bank entry policy on competition has been analyzed in several studies. Tan (1989) shows that banking concentration as measured by the Herfindahl index increased between 1982 and 1988. The share of the five largest private commercial banks in the total assets of banking system rose from 33 percent to 54 percent over the same period.

The implication of this on bank margins is clear. The World Bank study (August 1988) shows that the Philippine banking system has enjoyed one of the highest bank margins in the world. This corroborates the finding of Lamberte (1982) that Philippine banks realized a net rate of return on their loans of between 3.5 to 5.0 percent per annum on loans, whereas US banks earned a razor-thin rate of return of between 1.7 percent to 2.6 percent. Lamberte (1991) also finds that the bank spread, adjusted for the intermediation taxes, realized by commercial banks has been increasing since 1981 and that most of it can be explained by the increasing concentration in the banking system.

More recently, bank entry and branching have been liberalized. However, the minimum capital requirement for the different types of banks has been raised, effectively raising the barrier to entry. Since the liberalization of bank entry, only two have applied for a commercial bank license.

Foreign banks are still prohibited from entering the domestic financial market. Existing foreign banks may open branches but they are not allowed to accept deposits. This has discouraged them from opening branches. A bill recently filed in Congress proposes to liberalize regulations on entry of foreign banks into the domestic banking system.

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Interisland Shipping

The commercial domestic shipping fleet registered in 1987 consists of 3,560 vessels with a tonnage capacity of 666.4 Gross Registered Tonnage (GRT). Liners account for about 26 percent of total number of vessels and 20 percent of total capacity. Of the total capacity of the 935 liner vessels, about 80 is owned by members of the Conference of Interisland Shipping Operators (CISO). The organization is dominated by five members.

The interisland liner shipping industry faces various problems, foremost of which are the cost and adequacy of shipping services. These in turn is to a large extent influenced by government regulations. The interisland liner shipping industry is currently being regulated by the government through the Maritime Industry Authority (MARINA).

The main regulatory activities of MARINA consist of regulating route capacity and pricing of liner shipping services. The route franchising system consists of three guiding principles which serve as impediments to the entry of new operators in the industry.

These are:

- Prior operator rule. If market conditions warrant additional capacity in a certain route, the existing operator will be given the first option to provide additional capacity. Other operators may be allowed to introduce a vessel in a route already served by an existing operator if new technology or better services are offered or he can demonstrate at a public hearing that the present operator is serving the route inadequately.

- Protection of investment rule. An operator who is given a franchise to operate on a certain route will be allowed a maximum of five years to develop the route during which time no other operator will be allowed to serve that route. After five years, the route will be opened to other operators.

- Capacity regulating rules. MARINA has the right to determine the needed capacity in all routes subject to franchising rules. The operator on a route is only allowed to change vessels or introduce extra capacity up to a maximum of 20 percent of existing capacity.

The rates charged by liners are likewise regulated by MARINA. The pricing mechanism, however, results in distortions on the rate of freight and passenger services and served as disincentive for operators to improve services.

The inefficiencies resulting from the regulatory policies have long been recognized. Various studies have already dealt with these issues and have recommended changes in the current regulatory system.

The *Interisland Shipping Regulation Study* of the National Transportation Planning Project (NTPP/ NEDA/ DOTC, 1986) notes that government regulation has not been able to balance capacity and demand as overtonnaging existed on many routes for many years. Moreover, there are major flaws in the tariff structure.

In a review of the transport sector, the World Bank (March 1988) finds that both the costs of interisland shipping to the shipping industry and the prices charged to the industry's clients are higher than they should be. The major factors driving up costs are: (a) existing arrangements for port handling, and (b) the presence of cartel in the liner services, indirectly supported by government regulatory policies limiting competition (by restricting market entry and price flexibility).

The *Subsector Study on Interisland Shipping* (Barlindhaug og Fuglum/ Development Bank of the Philippines, 1990) notes that the effect of the route franchising rules is to limit the entry of new operators in liner trades and to perpetuate the operations of established ones regardless of the quality of service. These rules are found to be effective in limiting entry but not in controlling excess capacity which is the primary objective of route franchising.

The most recent study, *The Interisland Liner Shipping Rate Rationalization Study* (Nathan Associates, 1991), cites the following adverse effects of government regulation on the industry:

- Since official rates are low, operators are not induced to accept the financial risks, thus preventing services from being initiated on some desirable routes.
- Low official rates particularly for agricultural commodities result in the shutting out of these commodities from the liners' preferential cargoes.
- The pricing policy has prevented operators from obtaining and offering appropriate, specialized capacity for some commodities.
- Government regulation has protected inefficient operation and overtonnaging on a route by disregarding these considerations when identifying needs for rate adjustments.
- The route franchising system not only limits competition and fails to take into account service standards but further protects inefficient operation and limits inducement to provide standard services.
- The regulatory framework has encouraged passenger overloading and low passenger service standards by: (a) preventing flexibility of service schedules to better meet demand in peak periods, and (b) holding third class passage rates at levels which have not generally kept pace with inflation.

Recognizing the problems inherent in the regulatory activities, the government has taken steps toward liberalizing and rationalizing entry and pricing in the interisland liner shipping industry. With respect to freight rates, the government has implemented a fork-tariff system, which allow operators to charge 5 percent below or above the reference rates for each of the four commodity groupings. Cargo rates for shipments of livestock, transit cargoes, and reefer boxes have already been deregulated. First and second class passage rates have likewise been deregulated. Although entry has not yet been completely liberalized, there were moves in that direction. For most of the routes, MARINA has already allowed the entry of a second operator.

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Flour Milling

Saldaña (1990) examines the Philippine flour milling industry to determine the impact of government policies and corporate response on consumer welfare. Describing flour milling before deregulation in 1986, Saldaña cites the sector as highly concentrated, with few large firms producing most of the market requirements. Aggregate market sales are estimated at about ₱15 billion per year.

In line with the import substitution policies of the 1960s, the government encouraged the establishment of flour mills through fiscal incentives and concessionary foreign exchange rates. Partly to help ensure the viability of the early entrants, the government imposed restrictions on entry of other companies. This limited the number of players in the sector, led to high concentration and created rent.

Later, Saldaña recalls that the government intervened more actively in the industry through monopoly of wheat imports up to 1985, price control, flour distribution, and import protection.

Saldaña describes government policies as supportive and "rent-seeking." He concludes that these policies led to large consumer welfare losses. Government profits and inefficiencies in its wheat import monopoly as well as adverse effects associated with price controls, border protection, regulation of entry and other policies restricting competition from domestic supplies and from imports reduced consumer welfare.

Flour mills also contributed to the consumer welfare losses by sustaining flour prices at levels in excess of "normal" returns and by operating at below-optimal scale levels. The eight members of the Philippine Association of Flour Millers (Pafmil) -- Republic Flour Mills (RFM), Liberty Flour Mills, General Milling Co., Pillsbury Mindanao Milling Company (now PILMICO Foods), Wellington Flour Mills, Philippine Flour Mills, Pacific Flour Mills, and Universal Robina Corporation -- acted in seeming fashion as a cartel. Certain observable patterns of cooperation, low production capacities, and past industry pronouncements, says Saldaña, can be considered cartel-like in nature. This behavior of the industry players was tolerated by the government.

Saldaña adds that the government was in fact instrumental in setting cartel-like conditions in the industry. Of special importance were policies allowing joint wheat imports or cooperative allocation, restriction of entry and imports of machinery and equipment (thereby creating rent for the incumbents), waiver of import taxes and duties during the adverse world wheat markets in the early 1970s, and exercise of price controls on a reactive basis, rather than on estimates of the long-run marginal cost of the industry.

According to Saldaña, rent-seeking policies are not undesirable offhand as these might be needed to attract resources to "develop" an industry (also the infant industry argument; see Frischtak, 1989; Doz, 1986). Once established, even concentrated industries would attract new entrants due to superior profitability, and benefits of competition sets in. The problem is when new entrants could not enter the sector either due to government policy or due to cartel behavior.

For Saldaña, the remedies are self-evident. Policy options include: strengthening of anti-trust or anti-collusion laws, allowing entry of new flour mills, expansion of existing ones and allowing flour imports. Liberalization measures since 1986, Saldaña also notes, appear to nudge the flour milling industry toward greater competition. This, according to Saldaña, offers far better potential for increasing consumer welfare in the future.

Maramba (1992) confirms the enormous losses caused by the government wheat import monopoly on the industry and consumers. Inept and bureaucratic management system, inefficient flour distribution system, wasteful storage practices, and inexperience in wheat importations resulted in flour price increases, rampant hoarding, overpricing and blackmarketing. Only cronies, he adds, benefited from the situation.

The Aquino government through deregulation and privatization policies decontrolled the industry in March 1986. Describing the post-1986 environment of the flour industry, Maramba notes the increase in competition since then and the consequent decline in flour prices.

Since 1986, all eight members of Pafmil expanded capacities. Additionally, there were four new entrants with an aggregate capacity of 400,000 metric tons -- Delta Flour Mills, Foremost Flour Mills, Purefoods Flour Mills, and Morning Star Flour Milling Co. The new entrants put a rival industry association, the Chamber of Philippine Flour Millers (Chamflour).

The resulting overcrowding led to the prevailing cutthroat competition but did not necessarily enhance consumer welfare. What happened, says Maramba, was that distributors and bakers extracted additional profits while increasing the prices and reducing the sizes of bread products.

The experience of flour milling shows that increase in competitiveness does not easily translate to consumer benefits owing to certain rigidities in the distribution system.

Pulp and Paper

Pulp and paper is targeted for a US$500 million Industrial Restructuring Program (IRP) loan from World Bank, provided it moves toward deregulation and reduction of protection. As pointed out by the Jaakko Poyry Oy study (1990), the industry thrived behind high protection. However, it is by and large fragmented, with 33 pulp and paper mills, most of them very small by international standards, and with machines over 20 years old. As a consequence paper production during the past 10 years has been unable to cope with consumption growth. The country had to rely on increasing amounts of paper imports.

The same study notes the existence of oligopolistic structures in each of the four major paper grades (newsprint, printing and writing, linerboard and fluting, and tissue). In newsprint, the Paper Industries Corporation of the Philippines (PICOP) controls 52 percent of total capacity. Trust International Paper Company (TIPCO) has another 38 percent of newsprint production capacity.

In the printing and writing capacities, the Bataan group (Bataan Pulp and Paper Mills, Mayleen Paper Mills) dominates with a 54 percent share of capacity. PICOP, with a 7 percent share in capacity, is the sole producer of uncoated mechanicals. In corrugating materials (linerboard and corrugating medium), PICOP is the main producer with 61 percent of total capacity. On the other hand, Manila Paper Mills and United Pulp and Paper Mills dominate the other boards and kraft segment with 62 percent of installed capacity. In tissue production, Kimberly-Clark and Holland Pacific are the market leaders with 67 percent of total capacity.

The study points out that the relative sizes of each market segment dictate a concentrated structure. Hence, it favors the continued existence of the oligopolies and advocates for further consolidations. Nonetheless, it doubts the ability of the market leaders to compete in the absence of high tariff protection. The structure imposes tariffs of 30 percent to 50 percent on almost all paper grades, encouraging misdeclaration and technical smuggling.

Accordingly, the study proposes a restructuring program featuring loans and incentives, coupled with tariff reduction,[5] to encourage industry players to consolidate and modernize. The alternative is the continued existence of an industry characterized by excessive tariff protection, inefficiencies and high consumer prices.

The policy prescription of Jaakko Poyry Oy for the pulp and paper sector suggests the following: dismantling of a policy-induced barrier (tariffs) to foster competition which is viewed as a compelling force for industrial restructuring. Inefficient mills will have to be phased out and others will have to move toward economies of scale and integration in order to survive.

Home Appliance Manufacturing

Under the TC-PIDS Joint Research Project, Tan (1989) examines the effects of tariff reforms on six product lines -- refrigerators, freezers, television sets, airconditioners, stoves/ ranges, and electric fans -- over the 1980-1984 period.

The home appliance industry started as an assembly-type operations. Fostered by import substitution policies and government programs such as the Electronics Local Content Program (ELCP), domestic firms gradually manufactured more parts and components locally. Lower sales taxes, tariffs and import restrictions on parts and components served as incentives to local manufacturers.

The industry consists of 25 to 30 firms, most of which manufacture several product lines. Almost all firms, with the notable exception of one or two, are either licensees or joint venture partners of Japanese or American manufacturers. The industry is dominated by two firms which accounted for about 40 percent of net sales in 1983. Oligopolistic competition characterized the industry.

Tan observes a successive reduction in average tariff rates from 75 percent in 1980, to 55 percent in 1982 and 45 percent in 1984, although tariffs on almost all appliances stood at the maximum 50 percent in 1984. Average tariff rates on direct and indirect costs were likewise reduced. The overall effect had been the reduction of both industry and product EPRs. Industry EPR was cut from 458 percent in 1980 to 119 percent in 1984. Product EPR which ranged 26 - 2919 percent was reduced to 19 - 277 percent.

[5] Executive Order 470 sets the tariff rates on all paper grades at 30 percent.

Reductions in EPRs were said to induce most firms to become more efficient, as shown in the decline of DRCs.

Import restrictions, observes Tan, have been pursued mainly to promote the local content program. Imports of appliances were banned while that of inputs were regulated. In 1983, however, appliance manufacturers were allowed to import inputs under the Progressive Export Program for Consumer Electronic Products (PEPCEP) as long as they could earn their foreign exchange. Tan shows that implicit tariffs derived from direct price comparisons were generally declining from 1980-1984 for all appliances.

One of the two market leaders (a producer of refrigerators, freezers and television sets) was observed to be reaping monopoly profits. It had achieved comparative advantage and did not need the 108 percent EPR it was enjoying in 1984. The firm was able to export 4.5 percent of its output.

Tan concludes that further tariff reforms should be accompanied by import liberalization. Lower protection will induce greater efficiency while reduction in the cost of imported inputs will displace the inefficient firms. Both sets of policies will set the stage for firms to achieve comparative advantage.

Textile Manufacturing

Mercado (1987) reports on the textile study component of the TC-PIDS Joint Research Project. Typical of an import substitution industry, the local textile sector has developed under a complex system of tariffs, import restrictions, and investment incentives. Although heavily protected, it is characterized by low profitability and inefficiency in the use of domestic resources. Competition within the industry is said to be weak and, as a consequence, motivations for modernization have been lacking.

The textile industry can be described as a differentiated oligopoly, that is, consisting of dominant firms surrounded by smaller rivals in specific segments of the industry. The manufacture of synthetic (polyester or staple) fiber is a monopoly. Grouped according to production activity, textile firms can be classified as: (a) integrated mills; (b) spinning and/or weaving mills; and others (knitting, dying, cloth finishing, texturizing, twisting, hosiery and extrusion).

Using the EPR and DRC as measures of protection and comparative advantage respectively, Mercado notes cross-section variations within the industry. Her findings are as follows:

- In terms of production activity, knitting, integrated manufacturing, and synthetic fiber manufacturing appear to be sheltered by exceptionally high EPRs relative of spinning/ weaving, on the other hand, which have less protection.

- Among the textile products, nylon textile, dyed cloth, denims and staple fiber are heavily protected while spun yarns is the least protected product.

- The firms receiving heavy protection such as knitting, certain integrated mills and synthetic fiber manufacturing are inefficient foreign exchange users while less protected firms under spinning and manufacturing are efficient foreign exchange savers.

- A larger market stimulates greater capacity utilization which can bring about an greater efficiency. This is shown in the comparisons of DRCs at reported capacity versus 100 percent capacity.

- Reductions in effective protection between 1980-1984 led to an overall increase in efficiency which is measured in terms of increase of output. [6]

- Price comparisons indicate that the implicit tariffs for a majority of the raw materials used by the textile industry are greater than the nominal protection rates of textile outputs. This implies that the system of protection favors the production of polyester fiber and filament yarn.

- Under a scenario of tariff rates ranging from 20 to 30 percent, the more efficient integrated and spinning mills may remain viable. The inefficient firms may have small chances of survival unless they cease the manufacture of products proven to have no comparative advantage.

One of the six case studies in this engagement deals with the manufacture of polyester fiber. Given the significance of polyester fiber as an input in the manufacture of yarns and fabrics, the conduct and performance of its monopoly producer has a critical bearing on the entire industry. Mercado notes that the inefficiency of the highly protected synthetic fiber manufacturer tends to spread within the industry. Among other proposals, the paper recommends dismantling the synthetic fiber monopoly and liberalizing imports of major textile inputs.

Tire Manufacturing

Likewise part of the TC-PIDS Joint Research Project, Tan, Impreso et al (1987) attempt to study the effects of import liberalization on the domestic rubber tire industry (hereinafter referred to as tire study). The industry is comprised of six firms, three of which produces automobile and truck tires (referred to collectively by the study as MNCS) and the other three, motorcycle, bicycle and scooter tires (referred as MBS).

According to the tire study, the MNC industry structure is an oligopoly in a ₱1.6 billion market. Product differentiation, technological know-how, huge initial capital requirements and advertising intensity serve as natural barriers to entry. There appears no to be formal collusion. Rather, what is evident is the fierce rivalry among the three players, with one player steadily encroaching on the market share of others, increasing its share from 28 percent to 35 percent and moving up from third to a close second over the 1983-1985 period.

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[6] It must be noted that output could be increased without necessarily gaining in efficiency. The measure of better efficiency is output per unit of input.

In the MBS tire industry, one dominant firm has cornered about two-thirds of the ₱100 million market, with two other small firms accounting for the balance. Entry barriers include technological know-how and capital requirements.

Tariff reforms in 1985 conferred EPRs in the range of 41 to 44 percent for the three MNCs. In October 1986, coming after the liberalization of tire imports, tariffs were increased from 30 percent to 50 percent, hiking EPRS to 71 to 81 percent. The reversion of tariffs to 30 percent in February 1988 decreased the EPRs to 45 to 56 percent. The EPRs for the MBS tire producers ranged from 48 to 58 percent in 1985. With the pending requests for tariff hikes, simulations by the study showed an increase in the EPR range to 89 to 114 percent.

Aside from tariff protection, the tire industry enjoyed nontariff protection in the form of tire import restrictions, preferential foreign exchange allocation and outright ban on tire imports. Import restrictions have protected the industry by a higher rate than those implied by tariff rates. Although they have not achieved comparative advantage as measured in the DRCs, the MNCs have managed to export a small fraction of their output. High product EPRs have resulted in high commercial profitability. The MBS likewise is profitable and has exhibited comparative advantage, although it has not gone into exports.

Unfortunately, the tire study falls short of its avowed objective, ending with a statement that "the effects and impact of import liberalization should not be assessed at this point." It stops at saying that liberalization of tire imports led to removal of nontariff restrictions but was offset by tariff increases. Aside from this, the study claims other effects such as the expected increase in linkages could not yet be felt.

Electric Power Industry

Ignacio (1989), in a graduate business thesis at AIM, discusses the monopolistic structure and entry barriers in the electric power industry. Basically, the industry generates, transmits, and distributes electric power. In terms of structure, this industry is composed of three players: (a) a power generator or "manufacturer," (b) power distributors, and (c) industry regulators.

The major entity which generates electricity in the country is the National Power Corporation (Napocor), a government-owned and controlled enterprise which runs 50 power plants producing a total of 22,944 gigawatts per hour (GWH). The country's largest enterprise in terms of assets, Napocor runs almost all power generating facilities and handles technical operations of electric cooperatives in more than 23 locations in the country. It is virtually the industry itself.

Power distributors consist of private utilities, electric cooperatives, and municipal or city electric utilities. The biggest among these is the Manila Electric Company (Meralco) which distributes 76 per cent of the electricity generated by Napocor.

Lastly, industry regulators are government bodies which oversee the operation, set guidelines, and impose sanctions on the other industry players. Included in this group are: (a) Energy Regulatory Board (ERB) which oversees the functions and the rate structure of the private utilities to ensure the welfare of the people covered by the franchised areas of the private utilities; and (b) the National Electrification Administration (NEA) which promotes rural electrification by encouraging and assisting electric cooperatives. This support by NEA may take the form of creating the cooperative itself, financing its start-up, training its manpower, etc.

The monopoly in the industry can be traced to policymakers' view that power generation could best be served by an integrated system under one entity (the argument of a "natural monopoly"). Presidential Decree 40 grants Napocor the monopoly over power development and distribution. Between 1978 and 1987, Napocor obtained control of the country's generation facilities, except for small-scale, low-volume, low-capital generating facilities maintained by small utilities in remote islands and provinces, and the diesel plants operated by private utilities.

Ignacio describes several entry barriers in the industry. The foremost barrier is scale economies; a new entrant will have to come in at a large scale or otherwise face a cost advantage. The huge capital requirements, estimated at ₱14 million per megawatt (MW), is considered a tough barrier. Ignacio claims Napocor has critical advantages independent of scale obtaining from the learning and experience gained in its over fifty years of corporate existence.

On the other hand, access to distribution is open to entrants as Napocor is willing to absorb into its transmission system the power output of any new generating plant, on certain conditions like mutually beneficial selling price and congruence with Napocor's expansion plans. Also, government policy in recent times has been to encourage entry particularly through Build-Operate-Transfer (BOT) schemes.

As noted earlier, Ignacio's treatment on entry barriers is general; nor does she elaborate on their effects. This is typical of graduate business theses which tend to focus on corporate strategy formulation. Her specific concern is to develop a corporate strategy for the privatization of Napocor. In this regard, an in-depth analysis of the monopolistic structures and barriers and focusing on consumer welfare losses is not the pressing issue in Ignacio's work.

Ignacio, however, errs in considering scale economies (the natural monopoly argument) as an entry barrier. Outward shifts in demand and technological changes have eroded the natural monopoly rationale for power generation. A monopoly in power generation is even unsustainable on pragmatic grounds (see Panzar, 1989; Brauetigam, 1989 for the theoretical constructs). This is precisely the reason why Executive Order 215 allows the private sector to enter into power generation, although it was only after the adoption of Build-Operate-Transfer (BOT) and similar schemes that several private sector firms entered into power generation.[7]

[7] The first power project completed under the BOT scheme was Hopewell's 210-MW gas turbine facility in Navotas, Metro Manila. There are 25 ongoing private power projects with an aggregate capacity of over 3,500 MW. However, Napocor retains the authority to approve private sector projects.

Ignacio, to a certain extent, addresses the negative effects of Napocor monopoly on consumers by arguing for privatization as a means to promote competitiveness while reducing the role of government in business activity. Again, we must point out that privatization will transfer monopoly power from government hands to the private sector which, in the Philippine context, might likely be Meralco. This will not necessarily result in increased consumer welfare unless regulations to reduce monopoly rents are effective.

To discipline the monopoly supplier, the recourse in the Philippine context has always been to regulate. This is to prevent excessive monopoly rents and deadweight losses. The key phrase is "efficient market outcome", which is not the case for both Napocor and Meralco. In the last two years, the Napocor has accumulated losses of almost ₱2.4 billion pesos as a result of what two Senate committees call "gross mismanagement, profligacy, incompetence, lack of vision, poor planning, and implementation." Napocor management has simply not been able to keep up with the growing technical sophistication of the power sector. The Executive branch is not entirely blameless as it likewise failed to anticipate long-term market demand and in fact has a hand in emasculating energy plans laid down during the Marcos regime.

Largely because of Napocor's perceived inefficiencies, public resistance to tariff hikes has been strong. The International Monetary Fund (IMF) has demanded the tariff increases to reverse the power monopoly's deteriorating financial conditions. To implement the latest tariff increase, the government announced a two-phase scheme (₱0.15 per kWh effective January 1992 and ₱0.0745 per kWh effective February 1992), simultaneously attempting to alleviate its impact with a reduction of oil products, including a ₱0.40 decrease in bunker oil price.

Meralco, on the other hand, is enjoying unprecedented profits, expecting to post over ₱1.5 billion for 1991.[8] Current policies allow Meralco to make automatic billing adjustments to recover increases in Napocor rates and other operating costs, including system losses which arise from distribution inefficiencies and pilferage.

The fact that Napocor is said to be suffering from deadweight or efficiency losses even as Meralco is said to be reaping monopoly profits suggests failure of regulations. The starting point therefore of all proposals concerning Napocor is to reexamine the regulatory framework and/ or the current pricing policies and to determine how to increase competition *for* the market, if it is not possible to have competition *within* the market (Demsetz competition see Noll 1989; Braeutogram 1989; Jaakow and Rose 1989).

[8] This was traced to the exorbitant margins on the electricity that it buys from Napocor (Tiglao, "Tale of Two Utilities," *Far Eastern Economic Review*, October 24, 1991). Meralco's average tariff in 1991 is 76 percent more than the average rate it is charged by Napocor, as against the 26 per cent enjoyed by Meralco's counterpart in Bangkok.

STUDIES ON POLITICAL ECONOMY

Of relevance to the engagement are political economy studies in the Philippine context. The literature is rather extensive. Necessarily, this survey has to be selective and focuses on studies that describe the interplay of political and economic agents during the martial-law years of the Marcos government and the first years of the Aquino governments.

The Political Economy During the Marcos Era

Haggard (1990) describes the martial-law government of President Marcos as an ideal-type weak authoritarian government, that is, one whose capacity to pursue coherent economic policies is limited by a number of factors. These limiting characteristics include: (a) the development of a class, the "crony" capitalists ; (b) broadening of the patron-client network; and (c) circumscribed powers of Marcos-appointed technocrats.[9]

Cronyism typified by dependence on preferential policies such as the grant of monopoly powers, protection, guaranteed finance, and government contracts is probably the main feature of the Marcos government (see E.S. de Dios et al, 1984; E.S. de Dios, 1988; Kunio, 1988; Montes, 1988b). In the Philippines, this was reflected in three areas of activity: (a) the monopolization of key agricultural markets such as sugar and coconut; (b) the development of business conglomerates through the extension of preferential finance and government contracts; and (c) use of government funds for the benefits of cronies and the members of the extended Marcos family.

Even before Marcos time, Kunio (1988) points out, rent-seeking capitalists, including crony capitalists, already thrive. [10] Typically, rent-seekers establish and use government connections to gain business advantages. They seek not only protection from foreign competition but also concessions, licenses, monopoly rights, and government subsidies (usually in the form of low-interest loans from government banks). The "ersatz capitalism" or capitalism dominated by rent-seekers was already prevalent in regimes before Marcos.

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[9] See also E.S. De Dios (1988) who says, "What made the technocrats a curious social phenomenon was that they had no obvious domestic constituency (aside perhaps from Marcos himself) and seemed more prone to represent the views of international lending institutions. . . .But for these very reasons the technocrats were a serviceable element in the Marcos dictatorship. Having no stable domestic constituency, they were ultimately beholden to Marcos for their positions and therefore vulnerable to being overridden in their decisions, as they were on many occasions."

[10] Kunio classifies rent-seekers into presidential families, crony capitalists, politicians-turned-capitalists, and capitalists-turned-politicians. The first government-connected capitalists were said to include Vicente Madrigal who had close ties with President Quezon. During the early post-war years, these include Amado Araneta and Jose Yulo who have been said to use government loans to buy sugar mills. In the 1960s, there was Jose Marcelo who built steel factories with low-interest loans. Then with martial law came crony capitalist and a large number of government-connected capitalists. See Lichauco (1988) for a different perspective. For instance, Lichauco considers controls in the 1950s as a catalyst for industrialization. Persons whom Kunio would refer to as rent-seekers are considered "nationalist industrialists" by Lichauco.

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It was, however, during Marcos time, that cronyism became the "instrumental basis of Marcos law" (Haggard, 1990; E.S. de Dios, 1988; Montes, M. 1988b). In a bid for political and economic hegemony, Marcos did not hesitate to expropriate the holdings of hitherto dominant traditional clans he referred to as the "oligarchs." [11] Some clans acquiesced to his rule and were coopted. Then to supplant the oligarchs, President Marcos fostered the new set of business leaders absolutely loyal to him. E.S. de Dios (1988) notes:

> "The fact that some traditionally prominent class were persecuted by Marcos while crony capital was fostered, initially encourage a theory -- later disproved by events -- that the cronies represented a sharp break from the development path followed by the old elite. However, it is evident the crony phenomenon was no more than a logical extension and culmination of the pre-martial law process of using access to the political machinery to accumulate wealth."

President Marcos further strengthened his grip on the power levers with the establishment of the *Kilusang Bagong Lipunan* (KBL) or New Society Movement, an umbrella organization for the provincial political dynasties. The KBL served as the vehicle to expand Marcos' patron-client network from the *Batasang Pambansa* or National Legislature to the smallest barangay. With the KBL and Marcos relatives dominating the political front, and the Marcos cronies in control of strategic business assets, Marcos had the stranglehold on the political structures. Other sectors were gradually marginalized in martial-law policymaking.

To a large extent, the participation of Marcos-appointed technocrats in the decision-making was only a veneer to legitimize the administration as seen in the fact that their elaborate development plans were invariably emasculated by the executive's discretion and decree-making powers.

The consolidation of power had their logical outcomes -- distortions in the markets, wasteful public spending, and pervasive corruption. In the noncrony capitalist sector, results included uncertainty, loss of confidence, capital flight and, lastly, open opposition.

The situation came to a head in the 1983 debt crisis when the moratorium cut off access to foreign exchange. Business sector opposition mounted and finally led to withdrawal of support for the administration. This, says de Dios, "contributed materially to the subsequent downfall of the Marcos regime. "

All too often, observes the World Bank (1991), "the combination of pervasive distortions and predatory states leads to development disasters. Reversing this process requires political will and a political commitment to development."

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[11] These so-called "oligarchs" refer to groups or conglomerates with interlocking interests in finance, foreign trade, extractive industries, or manufacturing. Doherty (1980) concludes that twelve banks, together with the government-owned Philippine National Bank (PNB), have held over 70 percent of all deposits in 1977. Moreover, these banks have 684 director interlocks with 305 financial, manufacturing and commercial enterprises. About 87 percent of these companies are non-public enterprises are mostly family investments. This points to how tightly the tight control of certain economic sectors by small groups of individuals. The overall picture painted by Doherty indicates that significant control of the Philippine economy is exercised by about 60 families. In an update of the study (c1981), Doherty presents virtually the same findings -- 81 families in ten banking groups have interlocking directorates with 453 companies in 32 sectors. Of the 32 sectors, 30 are concentrated sectors where only four or fewer control 35 percent of total sales.

The Political Economy After 1986

The predatory state gave way to a democratic polity in 1986. Because it was established through a revolution, the expectations were that it would lead to sweeping change and sharp contrast with the old regime.

In 1987 and 1989, country reviews by the World Bank lauded the Philippines' efforts to transform the policy environment from one characterized by pervasive distortions and a high degree of "rent-seeking" to a more open, transparent and neutral incentive regime (World Bank, 1987; 1989). It would appear then that the Aquino government had the political will for reforms.

Since then, the tone of The World Bank has turned more critical as rent-seeking structures continue to persist. In a memorandum released last February 1991 the World Bank reiterates that the country's recovery will ultimately depend on an infusion of competitiveness (as cited by Tiglao, April 1991). This could be achieved by dismantling cartels and removing protection from inefficient industries. The Philippine economy is said to be still dominated by "lords of privileges," who amass wealth and influence not by productive forces but through privileged access to a limited resource. Reforms will take root only if these privileged groups' grip on the economy is ended.

Echoing the Bank's view, Chikiamco remonstrates against rentier domination of society. Rentiers often block reforms to liberalize the economy and foster competition. They lobby for or enact measures (since they sit in Senate and Congress as well) that water down the impact of proposed reforms. Legislation becomes a means among them for creating and dividing rent.

The result is a "weak" state, unable to rise above narrow, self-serving concerns and easily manipulated by partisan, entrenched interests. There are policy deadlocks between the executive and legislative branches of government and also within departments of the executive branch. Government economic policies often lack coherence or are reversed whimsically -- for instance, when Executive Order 413 containing tariff reforms were enacted, then suspended on the evening it was to take effect, and followed by EO 438 which imposed an import levy before being succeeded by EO 470 which introduces anew the suspended reforms, albeit to some extent watered down.

To overhaul the political and social system, Chikiamco suggests specific proposals, drawing from two seemingly contradictory but mutually reinforcing philosophical themes. These are: (a) the use of market forces to erode and dismantle rentier power and privilege, and (b) government intervention to stimulate competition, to "equalize" opportunities and access to resources, and to promote genuine, not elitist, democracy.

Lim (1991) argues that reforms are most effective if there is a social consensus of their benefits among vital economic sectors and agents. In the Philippines, no such consensus exists. The private sector is divided on such vital reforms as import liberalization and peso devaluation. Usually, the dividing line defines those who benefit from preferential policies and those lose.

The euphoria of a return to democratic processes drowned out partisan interests and led to easy passage of some reforms. Paradoxically, the democratic space made room for opposition to later reforms. After 1986, Lim reports, the first round of import liberalization was executed with little opposition -- lifting quotas of raw materials, fruits, agricultural products, and some intermediate inputs, apparently because the first ones affected were the farm producers who were relatively unorganized. When the second phase started in 1988, there was a big outcry from big business, particularly the monopolies to be hit by the lifting of quotas (such as resins, glass). These interest groups were joined by the others who resented the first round of liberalization and by the nationalist sector. Highly organized, big business interests groups had been able to hinder the liberalization and deregulation reforms.

Mercado (circa 1988) recalls

> ". . . .conflicts and controversies only started to erupt as the Aquino government contemplated on lifting import licensing for raw materials such as steel, glass, paper, and resins and for products of large corporations like tires, appliances, flour, and medicines. This move elicited strong opposition from the private sector and sparked a debate between two officials of the Aquino government: then NEDA Director-General Solita Monsod and the Secretary of Trade and Industry Jose Concepcion. The latter appears in two different and conflicting roles. While being part of the government which espouses trade liberalization, he also owns businesses including highly protected appliances, meat products, and flour which are primarily geared towards the domestic market. This conflict of interest makes Secretary Concepcion press for a deferment of the program and work against its full implementation."

Lim concludes that some sort of social revolution may be necessary to establish a government that is free from political maneuverings and lobbying from powerful vested interests.

The above observations tend to support the view that the Aquino government's capacity and will to undertake reforms have been circumscribed by the growing power of interest groups just as the reforms during the Marcos era were limited by the dominance of cronies and Marcos clients in the policymaking structure.

The reemergence of several interest groups in Aquino policymaking served to dilute the initial revolutionary-reformist stance of her presidency. These include: (a) the elite interests who opposed Marcos, including large landowners and businessmen in manufacturing and finance, and (b) the traditional politicians and members of the elite who ran successfully for Congress.[12]

[12] "This is a country," writes Tiglao, "where elites have had a remarkable history of collaboration and conciliation after short contest for control of the state" ("The Philippine Paradox, *Far Eastern Economic Review*, 12 July 1990). In another article of the same issue, "Power to the Plutocrats", Tiglao notes the reemergence of at least nine big-business groups: (a) the old elite Spanish group which basically had monopoly access to a particular resource; (b) the industrial groups which benefited from the import-substitution programme; (c) raw materials exporters comprised by the mining firms, the coconut oil millers, and the sugar bloc; (d) the banking bloc; (e) non-Manila magnates with entrenched economic base in the provinces; (f) Marcos-era survivors who emerged with their fortunes intact and untouched by Aquino sequestration efforts; (g) the Aquino-era magnates or former Marcos oppositionists who regained their fortunes after the Marcos overthrow; and (h) the Chinese-Filipino magnates.

The very breadth of Aquino's coalition support, her own commitment of a democratic government, and cabinet factionalism, says Haggard, checked the reform process. Reforms that would exact costs on her supporters proved difficult to implement. "This", Haggard points out, "is the dilemma of democratic reformism."

IMPLICATIONS: STYLIZED FACTS

The above literature survey gives a set of "stylized facts" that taken together describes how Philippine market structures and entry barriers look. Among these are:

- Given high concentration ratios, the manufacturing sector can be characterized as monopolistic (Lindsey, 1977). Capital intensity and the degree of fabrication act as barriers to entry (Lindsey, 1977). The degree of capital intensity, minimum efficient scale, and working capital requirements serve as entry barriers and lead to concentration (E.S. de Dios, 1986).

- High levels of concentration lead to monopoly power (Lindsey, 1977). Establishment concentration permits the earning of monopolistic profits (E.S. de Dios, 1986). High profits attract new entrants and eventually diminishes concentration (Lindsey, 1978).

- Tariff protection leads to concentration (E.S. de Dios, 1986). Nontariff measures also result in concentration (L.C. de Dios, 1987). High protection due to tariffs and import restrictions gives rise to inefficiencies (see subsector studies).

- Oligopolistic structures reduce consumer welfare and mask inefficiencies of industry players (see subsector studies).

- Rent-seeking lead to the rise of oligopolistic/ monopolistic structures (see Haggard, 1990; E.S. de Dios, 1988). This appears evident in both the Marcos and Aquino presidencies as well as in previous regimes (Kunio, 1988; Doherty, 1980).

- Rents arise from: (a) special privileges granted by the government through the powers of licensing and regulation; (b) a dominant position in the market, usually because of artificial barriers to entry; (c) ownership rights; (d) special access to resources; and (e) system of protection accorded by high tariff rates or quantitative restrictions (Chikiamco).

- The oligopolistic structures, and thereby entry barriers, have persisted. Reforms such as tariff reduction and import liberalization can increase competitiveness and lead to efficiency (Tan, 1989; Mercado, 1988; World Bank).

- Vested interests often block efforts to introduce reforms required to increase competitiveness (Lim, 1991). The reentry of established social forces in government raises barriers as well (E.S. de Dios, 1988; Haggard, 1990). Policymakers must seek for a counterweight to these groups or put together a coalition to push reforms.

Part II

CASE STUDIES

Telecommunications (Telephone Services)

Manufacture of Man-Made Fibers

Glass Manufacturing

Cement Manufacturing

Iron and Steel Making

Manufacture and Assembly of Motor Cars.

CASE STUDIES

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I TELECOMMUNICATIONS (TELEPHONE SERVICES)

BACKGROUND

Definition of the Industry

The telecommunications sector covers a broad range of services which include the following: (a) telephone services (voice); (b) record services (telex, telegraph, data communications, etc.); (c) radio paging services; and (d) carriers' carrier services (satellite).

This study focuses on the telephone services (voice) subsector which covers the following:

- Local exchange service - refers to local or non-toll voice-to-voice communications service among individual subscribers within a contiguous geographic area (the exchange). The transmission is principally via wire or physical links. A uniform rate schedule is charged throughout the exchange.

- Inter-exchange or domestic long distance service - refers to inter-municipality or inter-provincial telecommunications service, connecting local exchanges or subscribers within the country and for which there is a charge separate from the rate schedule applied to subscribers within a local exchange area. A carrier operating the long-distance network is sometimes referred to as inter-exchange operator or backbone operator.

- International service - refers to communications between subscribers in two countries. Common carriers providing this service operate an international switching center or gateway which is the point of entry and exit of international communications.

- Cellular mobile telephone service - is a public radio telephone service which by means of mobile, portable, or fixed terminal equipment, gives two-way access to the public switched telephone network (PSTN) and other mobile telephone stations.

Emergence of the Industry

The country's first telephone system was established in Manila by the Spanish government in 1896. Since then, the government has continued to set up telephone systems, though on a limited scale. However, it has been the private sector, primarily through the Philippine Long Distance Telephone Company (PLDT), which widened service area coverage and expanded the long distance telephone network.

PLDT's original franchise, granted in 1928, authorized it to acquire existing telephone systems in the country to pave the way for long distance calling. This enabled PLDT to gain control of telephone companies operating in Manila, Panay, Negros and Davao. The acquired firms served as the nucleus for PLDT operations all over the country.

A few months after the company's formation, the first toll link was established between Manila and Baguio. Since then, other toll links, both domestic and international, were established. World War II devastated PLDT facilities but by 1953, the number of phones in service exceeded prewar levels.

During the 1950s and 1960s, local telephone operators proliferated in view of the liberal granting of franchises. Many operators later proved financially weak and unable to keep up with the demands for service and capital requirements of the business. Others, lacking financial resources or using incompatible equipment, could not interconnect with the PLDT backbone and remained isolated.

Beginning in 1960, PLDT embarked on successive expansion and modernization programs, from the Phase 1 or X-1 program (1961-1965) to the ongoing X-5 (1989-1991) and X-5C (1991-1993) programs. These increased the number of telephones from less than 100,000 by 1960-end to more than a million by 1990-end and to a projected 1.3 million by 1993-end. Gross telephone plant stood at almost ₱ 35 billion by 1990-end.

INDUSTRY PROFILE

Industry Structure

Telephone services are offered by both the government and the private sectors, with the private sector accounting for about 96 percent of total connections. One company dominates the industry, accounting for 94 percent of total connections while 50 other companies operate the remaining 6 percent. Table 1.1 shows the market structure of the telephone services industry.

Table 1.1
Market Structure for Telephone Services Industry

Type of Service/ Facilities	Franchised Operators	Market Structure
Local exchange	PLDT Piltel Digitel Government carriers Small private operators	regulated monopoly in each franchised area
Domestic long-distance network	PLDT */ Telof	regulated monopoly
International gateway	PLDT ETPI Philcom	regulated monopoly until 1989; regulated competition since 1989
Cellular mobile telephone system	PLDT Piltel Extelcom Isla Communications	regulated competition

Note:
*/ Other operators can provide long distance services if they are interconnected with PLDT facilities.

The profile of each major player are discussed below.

- Telecommunications Office (TELOF)

TELOF, an agency created under the Department of Transportation and Communications (DOTC) by virtue of Executive Order (EO) 125, operates local exchange services primarily in rural areas left unserved by the private sector. It operates long distance telephone facilities in Regions 1 and 2 and public long distance telephone calling booths in various parts of the country. TELOF is also the implementing agency for the National Telephone Program (NTP), which aims to develop an homogeneous national toll network on the eastern part of the country.

- Municipal Telephone Project Office (MTPO)

MTPO is newly created under the Municipal Telephone Act of 1989 which provides for the establishment of a Public Calling Office (PCO) in every municipality of the country. The MTPO oversees the Municipal Telephone Project (MTP) which will put up 1,141 PCOs nationwide. The provision of facilities and services in 556 municipalities will be undertaken by the MTPO through grants from the Canadian and French governments and through budgetary appropriations. The rest of the PCOs will be put up by the private sector, namely PLDT, Piltel, Digitel, Extelcom, PT&T, and Eastern Visayas Telephone Company (Evtelco).

- Local Government Units (LGUs)

In the absence of private sector systems, various LGUs have established their own local exchanges. Some of these government-owned and operated exchanges are located in major cities and municipalities while others are in rural areas which failed to attract private investments. Some of the LGU-operated systems are the Misamis Oriental Telephone Company in Cagayan de Oro, Davao City Telephone System, and the Municipality of San Jose Telephone System.

- Philippine Long Distance Telephone Company (PLDT)

PLDT is the country's largest voice carrier, in terms of facilities, services offered, area coverage, number of connections, and revenues. As of 1990-end, it controls some 94 percent of phones in service and 86 percent of total line capacity. It is the sole operator in Metro Manila.

PLDT also owns and operates the most extensive nationwide transmission network (backbone) and two international gateways. Its toll network links up 349 cities and municipalities throughout the country. As the sole operator of the most extensive toll network, local exchange operators have to interconnect with PLDT facilities to be able to provide long distance services.

Prior to 1989, it was the sole gateway operator in the country. To date, its international switching center still serves as the main gateway for worldwide telephone traffic to and from the Philippines.
PLDT was the first to operate a Cellular Mobile Telephone System (CMTS) in the country. As of 1990-end, it has a total of 9,799 subscribers. Other PLDT services include leased lines for voice, data and facsimile transmission for use of other entities.

- Pilipino Telephone Corporation (Piltel)

Piltel, a subsidiary of PLDT, operates local exchange systems in several locations, including Baguio City; Olongapo City; General Santos City; and Puerto Princesa City. It also holds a franchise to operate a nationwide CMTS and is a participant of the MTP.

- Eastern Telecommunications Philippines Inc. (ETPI)

ETPI, established in 1974, provides international telecommunications services such as telex, telegraph, dedicated circuit, database access, facsimile, press bulletin service, mailgram, and phonogram. It is an affiliate of Cable and Wireless, a British-owned firm, which has an equity share of 40 percent. Although it has been providing primarily record and data services, it has correspondent agreements with a number of countries such as Hongkong, Taiwan, and Singapore. In 1989, it was granted a legislative franchise to operate the country's second international gateway, enabling it to provide direct international telephone services.

- Digital Telecommunications Philippines Inc. (Digitel)

Digitel, established in August 1987, is also an affiliate of Cable and Wireless. It has obtained municipal franchises to provide local telephone services, initially in the provinces of Bulacan and Pampanga. It is a participant in the MTP, covering 26 municipalities in Central Luzon. At present, it is awaiting Congressional approval of its franchise to provide nationwide telecommunications services.

- Philippine Global Communications Inc (Philcom)

Philcom is another major record carrier providing international telecommunications services. It is an affiliate of RCA Global Communications, an American firm, which owns 40 percent of Philcom's capital stock. In 1989, the company was granted a franchise to operate an international gateway for international telephone services. The gateway became operational on February 1992.

- Express Telecommunications Company (Extelcom)

Extelcom has a franchise to operate a nationwide CMTS. It started operations only in July 1991 and is currently serving the area of Metro Manila. It is a participant in the government's MTP, accounting for 122 municipalities in Mindanao.

- Philippine Telegraph and Telephone Corporation (PT&T)

PT&T, previously engaged primarily in record and data communications services, recently ventured into telephone services by participating in the MTP through the provision of 192 PCOs.

PT&T is wholly owned and controlled by Telectronics Systems, Inc. (TSI), which owns another common carrier, Capitol Wireless Inc. (CAPWIRE). PT&T itself has majority control of Pocket Bell, Philippines, and minority shares in Radio Communications of the Philippines (RCPI), another record carrier.

Well established in data communications, telegraph, and telex services, PT&T looms as a potential player in telephone services. Considered as the national domestic telex carrier, PT&T possesses a modern digital switching system which is interconnected with CAPWIRE and ETPI. Its own backbone system can be used to provide telephone services, aside from its present services.

- Other small private telephone companies

As of 1990, there are 43 other private local exchange operators (aside from PLDT) providing services in various parts of the country. Some of these operators remain unconnected with the nationwide toll network, thus limiting their services to purely local calls.

In summary, PLDT has the competitive edge in all segments of the telephone sector: local, domestic long distance, international long distance, and cellular mobile phone. Given its state-of-the-art digital equipment, it is also in a strong position to move to other segments of the telecommunications sector such as data communications through the ISDN [1] framework.

Nonetheless, strong rivals are coming into the picture. ETPI is making spirited bids to encroach on PLDT international markets. Philcom has already operationalized the country's fourth international gateway.

Digitel is trying to outflank PLDT in Central Luzon, operating phone services initially in Bulacan and Pampanga and eventually in Tarlac, Zambales. and Bataan. With a ₱ 40 billion bid, it bested PLDT for the lease operations of the government's Regional Telecommunications Development Project (RTDP) and NTP Tranche I (NTP-I) backbone systems. If it succeeds in getting the award, Digitel can link up the phone systems of Regions I and II with its franchises in Region III and establish an homogenous toll network in the northern and central parts of Luzon. By linking with ETPI's gateway, it can provide international phone services.

PT&T is a potential key player in telephone services (just as PLDT is a potential rival in the record/data communications services). Through Pocket Bell's paging services, it already offers a substitute for telephone services. Already well established in data communications, telex, telegraph, and other telecommunications services, PT&T can easily use its digital backbone for telephone services.

Although there are new entrants, PLDT's position as the dominant player is well-entrenched. The extensiveness of PLDT's network and the magnitude of its investments can not easily be matched by any other player.

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[1] Integrated Services Digital Network (ISDN) is a switched network providing end-to-end digital connectivity for simultaneous transmission of voice and/or data over communications channels and employing protocols that conform to internationally defined standards.

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Policy and Regulatory Framework

Policy-making and regulation of the industry is vested in the Executive Branch, the Legislative Branch and the Local Government Units. The Executive Branch, through the DOTC and the National Telecommunications Commission (NTC), sets the goals, policies, and strategies on telecommunications and regulates the industry to ensure rational development. On the other hand, the Legislative Branch and the LGUs are empowered to grant national and local franchises, respectively.

DOTC implements plans and policies on the telecommunications sector through the NTC, a quasi-judicial agency attached to the DOTC for administrative supervision. As a quasi-judicial body, its decisions are appealable only to the Supreme Court. Prior to its creation in 1979, regulation of the sector was under the Telecommunications Control Bureau and the Board of Communications. The NTC's main regulatory functions cover the issuance of licenses to operate, called Certificates of Public Convenience and Necessity (CPCN), rate regulation, and the establishment and enforcement of rules and standards governing the issuance of CPCNs.

Private operators who intend to provide commercial telephone services are required to secure a franchise either from Congress for a national franchise or from the LGUs for a local franchise. Government-owned systems, however, are not required to obtain legislative franchise nor do they operate under the purview of the NTC.

A franchise is a legal instrument which confers upon existing corporations or entities the right and privilege to use public property for their private businesses. To obtain a franchise from Congress, a bill sponsored by a Congressman from the area (base of operation) should be filed in Congress. Like any other bill, the application for a franchise goes through the usual procedures for enactment of a law.

After a franchise is granted, the enfranchised operator should obtain from the NTC a CPCN. Unlike the terms of the franchise which can be general in scope and coverage, the terms of the CPCN are more specific and detailed. A CPCN specifies the period, area of operation, type of service to be provided, rates to be charged, and other service commitments from the operators. Amendments to the original CPCN is needed for every expansion, extension, conversion or modernization of facilities and services, and changes in rates.

As part of its quasi-judicial functions, the NTC conducts hearings on the application for CPCNs so that the public and competitors are given a chance to oppose the application.

In evaluating applications for CPCNs, the applicant should show that the legal requirements are satisfied, he is financially capable of undertaking the proposed service and meeting the responsibilities incident to its operation, and that the project is financially and technically viable. In rendering its decision, the NTC is guided by the primary principle of promoting the public interest. Thus, the applicant should prove that the operation of the proposed public service will promote the public interest in a proper and suitable manner.

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As part of its regulatory functions, the NTC also regulates the rates charged by telecommunication companies. Any requests for rate adjustments have to be approved by the NTC. NTC sets rates based on a 12 percent rate of return ceiling imposed on public utilities. The 12 percent rate of return is computed based on the net book value of property, plant and equipment plus working capital equivalent to two months average operating expenses.

GENERAL ASSESSMENT

Policy-Induced Barriers to Entry

Up to the mid-1980s, barriers induced or caused by government policies restricted entry into the telephone services sector along the principles of natural monopolies. After 1986, the sector was opened to greater competition but the dominant player is likely to remain entrenched.

The telephone services industry in the Philippines is dominated by the PLDT which spearheaded the development of telephone facilities throughout the country. PLDT got the sole authority to establish a nationwide long-distance network in the country and, to date, remains the sole owner and operator of a nationwide telephone backbone. Other telephone companies are small, located outside of Metro Manila and offering mostly local services. Only if interconnected to PLDT's facilities can these firms provide long distance calls.

PLDT's dominant position in the industry has been established through more than seven decades of corporate existence. From gross property, plant and equipment valued at ₱26 million and 28,964 telephones in service in 1952, it has now grown to be a multi-billion company with property, plant and equipment valued at ₱35 billion and about one million telephones in service in 1990. This growth of one dominant carrier was propelled by structural factors and reinforced by government policies.

PLDT's franchises such as the highly lucrative Metro Manila local telephone exchange as well as the domestic and national long distance toll services, have been granted in line with the principles of natural monopoly. The telephone services industry, like other public utilities, has long been regarded as a natural monopoly. The rationale is that the technology utilized to provide telecommunication facilities requires scale economies which can only be achieved under a condition of "natural monopoly."

Under a monopolistic market structure, government regulation is warranted to ensure that the monopolist will work not only towards achieving financial objectives but critical public interest objectives as well. This is to avoid excess monopoly rents and deadweight loss (see Brauetigam, 1989; Noll, 1989; Joslow and Rose, 1989). Thus, the telecommunications sector is subject to government regulatory control, particularly on entry and pricing.

Even the multiple grant of local telephone franchises, seen during the 1950s and the 1960s, reflects the natural monopoly argument. In specific geographic areas, only one single provider was enfranchised for telephone services. However, the lack of coordination among the various levels of government units in charge of granting franchises and the apparent absence of clear-cut policies resulted in a highly fragmented sector characterized by duplication of facilities and lack of interconnection.

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During the period 1973 to 1986, the government issued a number of decrees and circulars aimed to avoid further fragmentation in the sector. Incentives were given for consolidation and mergers. Duplication of facilities was not allowed.

The Board of Communications (BOC) Memorandum Circular (MC) No. 2 dated 5 June 1973 encouraged the interconnection of facilities and systems and the merger, consolidation or amalgamation among domestic common carriers to prevent wasteful duplication of services and unnecessary competition.

This was further reinforced by Presidential Decree No. 1756 dated 1 January 1981 which provided incentives for the merger or consolidation of public utilities, especially telecommunications, to further promote the financial stability and capacity of public utility operators.

It was during this period that PLDT acquired a number of firms such as the Piltel, the Republic Telephone Company (then the second largest operator), Zamboanga Telephone Company and Pineda Telephone Company.

Several NTC MC also established the dominant position of one common carrier. MC No. 08-8-83 dated 25 October 1983 designated PLDT's International Transmission Maintenance Center (PLDT ITMC) in Metro Manila as the sole international gateway for telephone services. Likewise, MC No. 2-02-85 dated 7 March 1986 gave priority to the nationwide operator, PLDT, to expand services and acquire existing systems in line with the rationalization policy of the government to limit the number of telephone exchange operators.

All these measures, while aimed at improving the utilization of resources and at rationalizing the sector's development, concentrated services and facilities in one firm. PLDT was able to make judicious acquisitions of local telephone companies and, through interconnections with its domestic and international toll services, managed to establish a truly nationwide telephone system.

In short, the government policies erected barriers on the basis of natural monopoly conditions and further favored the position of the leading monopolist. Behind this favorable policy regime, the dominant firm undertook successive modernization and expansion programs to strengthen its position in the marketplace.

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Structural Entry Barriers

Aside from policy-induced barriers, industrial organization-related factors also inhibit entry. Moreover, incumbents have also exhibited severe reactions to moves by new entrants.

- *Huge capital requirements*

  Perhaps, the most formidable barrier to new entrants are capital requirements. Substantial sums of money are needed for start-up capital and acquisition of technology and equipment for telephone services. Rapid advances in technology necessitate the continuous infusions of fresh capital to finance modernization programs. The capital intensiveness of telephone services limits the number of likely entrants.

  Table 1.2 which shows the investments of PLDT since the start of its major expansion programs give an indication of the magnitude of capital requirements to develop its telephone system.

Table 1.2
PLDT Investments in Telephone
Systems Development

Program	Year	Tel. lines	Cost(₱ M)
X - 1	1961 - 1965	42,000	587
X - 2	1966 - 1972	185,000	876
X - 3	1973 - 1978	78,520	1,120
X - 4	1979 - 1988	216,000	18,000
X - 5	1989 - 1991	129,000	7,300
X - 5C	1991 - 1993	355,000	13,860

Notes:

1. The X-1 program extended the microwave long distance service throughout Luzon and Visayas and started the conversion of provincial exchanges from manual to automatic.
2. The X-2 program extended the microwave network to Mindanao and completed the conversion of exchanges to automatic.
3. The X-3 program improved toll facilities.
4. The X-4 program installed electronic switching lines and established digital toll exchanges.
5. The X-5 will provide additional electronic digital lines and increase domestic and international toll circuits. A new digital microwave backbone composed of five microwave systems will also be established.
6. X-5C will further add electronic digital lines. New digital local exchanges and remote subscriber units will be established.

Source: PLDT, PLDT Fact File.

Even for local exchange operations, substantial sums of money are needed. Digitel estimated that it will cost about ₱2.7 billion to install 57,000 single line connections over five years and another ₱7.1 billion to increase capacity to about 300,000 lines in 20 years time. It is only through joint-ventures with foreign partners that Digitel has been able to hurdle this barrier. However, the inflow of foreign investments is constrained by the constitutional provision limiting foreign equity share in public utilities to a maximum of 40 percent.

Also for this reason, new entrants are likely to come from the ranks of major telecommunications firms. ETPI and Philcom were both longtime international records carriers and, to some extent, already have the required facilities in place. PT&T, seen as a potential entrant, is the country's leading domestic record carrier.

For potential entrants such as other telecommunications firms with track record and existing facilities, other barriers such as access to factors of production; brand loyalty; effects from the learning or experience curve; etc. would even be less difficult to overcome.

- *Access to long distance network*

Access to favored distribution channels is considered by Porter as a separate barrier type. PLDT's dominant position stems from its control of a domestic long distance network which is not only the most extensive but also well placed in terms of high-growth regions served. The other existing backbone in Regions I and II serves backward areas.

Operators wishing to provide toll services have to interconnect their facilities with PLDT which, as a monopoly, can influence the terms and conditions for interconnection and the revenue sharing scheme between interexchange carriers (gateway and backbone operators) and local operators. Unless potential entrants can be assured of interconnection with PLDT facilities and will receive adequate share in toll revenues, they may not find entry attractive.

To address this concern, the government has imposed mandatory interconnection of all telephone systems and revised the revenue sharing arrangements to make these less biased against local operators. Under the new toll sharing arrangements, the revenue share of local operators was increased.

- *Incumbent reactions*

Although not a barrier class under Porter's or Bain's classifications, incumbent reactions can pose barrier to entry. Several events can be cited to illustrate the reactions of incumbents against new entrants:

(a) the dispute on the international gateway between PLDT and ETPI and between PLDT and Philcom, and on interconnection between PLDT and Extelcom.

PLDT vs ETPI, Philcom

Philcom's application to operate an international gateway was met by stiff opposition from PLDT. PLDT questioned Philcom's financial capability to operate a gateway and the reported high cost of interconnecting the new gateway with PLDT's facilities. PLDT also argued that competition will lead to the loss of cross-subsidy from international services which is essential to achieve the goal of maximum service coverage in the local network.

PLDT likewise opposed ETPI's application for another gateway during public hearings conducted at NTC. NTC's decision in favor of ETPI was also questioned by PLDT in court. In opposing ETPI's application, PLDT argued that it can adequately serve the market with it's existing facilities and planned expansion program. Thus, ETPI's gateway will only lead to "unjustified duplication of service".

One consumer group, the Philippine Consumers Federation Inc. (PCFI), however, favored the retention of PLDT's monopoly in gateway operations. PCFI expressed its concern that the entry of other gateway operators would reduce PLDT's revenues from international toll services and thus, reduce the subsidy for the local telephone network. The reduction in the subsidy may then result in higher subscription rates for telephone services.

PLDT vs. Extelcom

As the operator of the long-distance backbone network, PLDT can also set back the operations of other companies by refusing or delaying interconnection of facilities, as in the case of Extelcom.

When NTC issued the directive for the two companies' interconnection, PLDT questioned the validity of Extelcom's franchise in court delaying the preparation of an interconnection agreement. PLDT asserted that Extelcom's franchise, previously granted by Congress to Felix Alberto Co., Inc. was non-transferable unless approved by the present Congress. The Supreme Court, however, affirmed the legitimacy of Extelcom's franchise.

Although Extelcom was given a CPCN in 1989, the interconnection agreement between PLDT and Extelcom was signed only last March 1991. However, even after signing, PLDT still managed to delay action on the approval of the installation of Extelcom equipment.

(b) The current move of the Philippine Association of Private Telephone Companies (Paptelco) to block the award of the RTDP/NTP-I lease operation bid to the first ranked bidder, Digitel. Paptelco was the last ranked among the four bidders.

(c) PLDT's successful efforts to get a franchise allowing it to offer voice and data services, if need be. This could be interpreted as a preemptive move to prevent potential entrants from other telecommunications services to encroach heavily into the telephone services. With the franchise, PLDT could move into other services as well.

Impact of Barriers

Industry

The lack of competition in the provision of telephone services and the inability of the regulatory agency to impose service commitments may have resulted in the slow pace of telecommunications development in the country.

- Slow growth in telephone facilities

  During the period 1979 to 1990, the total line capacity and connections grew by an annual average rate of only 4 percent. The National Telecommunications Development Plan (NTDP) Report noted the slow growth in the telecommunications sector in the Philippines compared to other Asian countries. The Philippines had the second lowest telephone density among five Asian countries in 1988 (see Table 1.3). As of 1990, telephone density in the country stood at only 1.4 main stations [2] per 100 population while the average telephone density index for the ASEAN region is 8.3.

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[2] Main station refers to an access point to the public switched telephone network. A single line, a single party on a party line or a trunk line of a private branch exchange is counted as one main station.

Table 1.3
Comparative Telephone Density
of Asian Countries

Country	1976	1988
Philippines	0.70	1.00
Thailand	0.55	1.70
Indonesia	0.16	0.37 */
Malaysia	1.58	6.50
Korea	3.54	20.50

*/ 1985 data

Source: NTDP, 1990

Some of the reasons for the slow growth in telephone density are the following:

- poor financial viability of local exchange operators primarily due to: (a) lack of interconnection to the backbone network; (b) low share in toll profits for those interconnected to the backbone network; and (c) low tariff rates from local subscribers;

- expansion of profitable voice carriers are partly hampered by regulatory constraints. A lengthy and costly process is required before a new entrant can begin installing much needed telecommunications system;

- high domestic interest rates which stifle investments; and

- low access to foreign credits. This has been partly addressed by the government by including telecommunications projects as one of the priority areas eligible for private sector access to Official Development Assistance (ODA).

• Unbalanced rural-urban distribution of telephone service

Growth in telephone service has been concentrated largely in major cities/municipalities. Metro Manila accounted for more than 70 percent of total telephones in service. As of 1988, about 82 percent of total towns in the country remain unserved. Among the existing towns with service, telephone density varied widely. Major cities and municipalities have an average density of 4.03 main stations per 100 population with Metro Manila having the highest density at 5.51. Other smaller towns have an average density of less than 1.0 (see Table 1.4).

One of the reasons cited in the NTDP for poor service distribution is that the obligation to serve has not been effectively impressed upon service providers resulting in minimal rural expansion. In the absence of effective regulatory policies, all carriers operate as profit maximizers, mostly in urban areas or as marginal ineffectual operators mostly in rural areas.

The implementation of the Municipal Telephone program will however, expand telephone service coverage to all municipalities with the establishment of PCOs in every municipality in the country.

Dominant Firm

PLDT's position of dominance stems from its exclusive franchise in the domestic and international (up to 1989) long distance telephone systems. These franchised operations were granted apparently in line with the principles of natural monopoly. Government policies in the 1970s up to the early 1980s restricted entry into the industry and further served to strengthen PLDT's dominant position. PLDT also reinforced its position through continuous expansion and modernization programs. From total assets of ₱70 million in 1970, PLDT has grown to be a multi-billion company with total assets of ₱36 billion by 1990-end.

As the sole owner of the nationwide backbone network and the international gateway (up to 1989), it was able to reap profits from the most lucrative market segment (long-distance services). Long-distance operations account for over 60% of PLDT's total revenues. Overall, PLDT's operations have been very profitable. It is one of the most profitable firms in the country. As shown in their financial statements (Table 1.5), its profits have steadily increased.

Consequently, PLDT has no worthwhile competitor to speak of. This situation is, however, double-edged. It is able to reap all monopoly rents arising from its franchise, but it is also held accountable for virtually all the industry's failures.

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Table 1.4
Telephone Service Penetration by Area
As of Yearend 1988

Area	Total Towns	% of Total Population	Main Stations Per 100 Persons	% of Main Stations To Total
PHILIPPINES	1565	100.0	1.03	100.00
Major cities/ municipalities	58	23.5	4.03	91.60
Smaller towns:				
with telephone service	225	23.1	0.37	8.37
without service	1282	53.4	0.00	0.00
METRO MANILA	17	100.0	5.51	69.10
LUZON	744	100.0	0.36	14.70
Major cities/ municipalities	24	10.4	2.20	9.20
Smaller towns:				
with telephone service	172	37.7	0.36	5.50
without service	548	51.9	0.00	0.00
VISAYAS	402	100.0	0.46	10.00
Major cities/ municipalities	13	15.2	2.75	9.10
Smaller towns:				
with telephone service	29	16.6	0.28	1.00
without service	360	68.2	0.00	0.00
MINDANAO	402	100.0	0.27	6.10
Major cities/ municipalities	4	12.2	1.55	4.20
Smaller towns:				
with telephone service	24	16.1	0.52	1.90
without service	374	71.8	0.00	0.00

Source: NTDP, 1990.

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Table 1.5
Philippine Long Distance Telephone Company
Financial Highlights
(In Million Pesos)

	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
SELECTED INCOME ACCOUNT ITEMS										
Total Operating Revenues	n.a.	6	7	9	10	11	13	14	16	17
Local Service	n.a.	5	6	7	8	9	10	11	13	14
Toll Service	n.a.	1	1	2	2	2	3	3	3	3
Total Operating Expenses	n.a.	5	6	6	7	8	9	10	12	12
Net Operating Income	n.a.	1	1	3	3	3	4	4	4	5
Net Income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	4
SELECTED BALANCE SHEET ITEMS										
Telephone Plant (Gross)	n.a.	26	29	33	37	43	50	59	77	80
Total Assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	70
Return on Assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	6 %
Total Stockholders' Equity	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	33
Return on Equity	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	12 %

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
SELECTED INCOME ACCOUNT ITEMS										
Total Operating Revenues	20	22	24	26	45	62	75	85	104	146
Local Service	16	20	20	21	30	36	40	46	57	76
Toll Service	3	4	4	4	14	25	34	38	46	68
Total Operating Expenses	14	14	16	17	25	32	40	47	59	88
Net Operating Income	6	8	8	9	20	29	35	38	45	58
Net Income	4	n.a.	n.a.	7	15	n.a.	n.a.	n.a.	n.a.	n.a.
SELECTED BALANCE SHEET ITEMS										
Telephone Plant (Gross)	93	103	107	172	241	268	349	448	555	908
Total Assets	80	n.a.	n.a.	147	214	n.a.	316	406	539	863
Return on Assets	5 %	n.a.	n.a.	5 %	7 %	n.a.	n.a.	n.a.	n.a.	n.a.
Total Capital Stock/Equity	38	n.a.	n.a.	52	84	n.a.	146	165	205	218
Return on Equity	11 %	n.a.	n.a.	13 %	18 %	n.a.	n.a.	n.a.	n.a.	n.a.

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
SELECTED INCOME ACCOUNT ITEMS										
Total Operating Revenues	191	228	294	350	412	476	543	627	748	1,021
Local Service	103	114	160	194	225	253	274	287	307	439
Toll Service	85	111	131	154	181	214	257	323	420	552
Total Operating Expenses	117	141	172	209	248	282	327	372	452	615
Net Operating Income	74	87	122	142	164	194	216	255	296	406
Net Income	n.a.	n.a.	n.a.	n.a.	105	132	170	187	206	251
SELECTED BALANCE SHEET ITEMS										
Telephone Plant (Gross)	1,029	1,146	1,206	1,343	1,573	1,743	1,906	2,268	2,974	4,151
Total Assets	972	1,068	1,218	1,287	1,417	1,705	1,741	2,223	2,914	4,038
Return on Assets	n.a.	n.a.	n.a.	n.a.	7 %	8 %	10 %	8 %	7 %	6 %
Total Capital Stock/Equity	239	258	351	413	494	606	752	912	1,285	1,465
Return on Equity	n.a.	n.a.	n.a.	n.a.	21 %	22 %	23 %	21 %	16 %	17 %

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
SELECTED INCOME ACCOUNT ITEMS										
Total Operating Revenues	1,266	1,622	2,499	4,311	4,718	6,059	6,591	7,734	9,459	12,839
Local Service	548	630	899	1,533	1,808	2,020	2,013	2,248	2,536	3,068
Toll Service	675	937	1,551	2,768	2,916	4,074	4,604	5,540	6,967	9,778
Total Operating Expenses	757	942	1,330	2,114	2,388	3,024	3,731	4,394	5,625	7,447
Net Operating Income	509	679	1,169	2,197	2,331	3,035	2,860	3,340	3,833	5,392
Net Income	n.a.	218	398	570	779	1,896	1,362 *1	2,230	2,061	3,187
SELECTED BALANCE SHEET ITEMS										
Telephone Plant (Gross)	6,808	8,658	12,417	16,238 *2	16,850 *2	18,759 *2	20,578 *2	22,571 *2	26,407 *2	34,965 *2
Total Assets	6,641	8,495	12,569	16,658	17,045	18,971	21,264	22,917	26,583	36,224
Return on Assets	n.a.	3 %	3 %	3 %	5 %	10 %	6 %	10 %	8 %	9 %
Total Capital Stock/Equity	1,854	2,377	2,650	3,011	3,563	5,230	6,261	8,251	10,111	13,558
Return on Equity	n.a.	9 %	15 %	19 %	22 %	36 %	22 %	27 %	20 %	24 %

NOTE : n.a. means data not available
*1 - Net of the corporate income tax per E.O. #72
*2 - Property, Plant & Equipment
Source : PLDT Annual Reports

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Users

The following can be cited as some of the effects of the presence of entry barriers in the industry:

- The quality of service leaves much to be desired. Based on certain quality of service indicators, the NTDP noted the poor quality of telephone services in the country in 1988 (see Table 1.6). In 1991, however, PLDT reported some improvements in its quality of service.

- There is a large unmet demand for telephone services. It was estimated that there are about 400,000 pending applications for telephone connections with PLDT. Because of the huge backlog, it takes an average of about three years before PLDT is able to provide an applicant with telephone. The ongoing expansion projects of PLDT are expected to cover this backlog.

- A large part of telephone facilities is outdated. As of 1990, only 15 percent of telephone exchanges have been converted to digital and some manual exchanges still exist.

- The expensive obsolete equipment bloats the value of the operating assets on which an allowable 12 percent profit is based. Thus, the users are penalized by paying higher costs for unsatisfactory service.

- The reduction in toll rates of about 20 percent brought about by competition in international services points to the fact that toll rates may have been set too high. However, the loss of the cross-subsidy from international services as a result of the rate reduction may also have contributed to the increase in domestic toll rates.

Table 1.6
Telephone Quality of Service Indicators
Nationwide Averages

Indicator	1988	1991
Percentage of service applications filled within four weeks	6 %	n.a
Trouble complaints per 100 telephones per month	17	12
Percentage of trouble complaints cleared within two days	89 %	95 %

Source: NTDP, 1990 for 1988 data; PLDT for 1991 data

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Policy Directions

Current Initiatives

The change of government in 1986 led to certain policy changes supportive of competition which to a certain extent lowered barriers to new entrants. Thus, policy pronouncements, seen in DOTC Circular 87-188, promote regulated competition in the provision of communications services.

The NTDP, which provides the development framework for telecommunications over the next 20 years, also defines a more liberal, more competitive environment for telecommunications development. As embodied in the NTDP, "the government's general policy is to move towards liberalization. The NTC will control the change process consistent with the national interest -- that is, move each market segment or service to an appropriate degree of competition at the appropriate time".

Recent events show the broadening of competition in telephone services:

- The interconnection of the facilities of all public communications carriers has been made mandatory. This is obligatory not only between local operators and PLDT but also even between competitors, e.g. Extelcom and PLDT. A new revenue toll sharing agreement increasing the revenue share of local operators (agreement between PLDT and Paptelco) for such interconnections has been approved by NTC.

- Entry into the supply of customer premises equipment (CPEs) has been deregulated. Consumers are not obligated to buy their equipment from supplier of telephone services.

- International toll services have been opened to competition with the grant of franchise and license to two other operators, aside from PLDT, to operate their own gateway facilities. The presence of competition proved to be beneficial to the end users because of the 20 percent reduction in toll rates for international calls.

- Competition was also allowed in the provision of cellular mobile telephone systems. Aside from PLDT and Piltel, another firm, Extelcom, was granted a franchise to provide nationwide services. Isla Communications has a local franchise to provide mobile phones in Cebu City.

- Government's thrust to privatize existing and planned government facilities also paves the way for the entry of other operators into the industry.

- There is pending legislation which will break the PLDT monopoly in national long distance telephone services. Senate Bill No. 1353 to be known as the Public Telecommunications Policy Act of the Philippines proposes the following industry structure and the extent of competition:

- Local exchange network: Geographic monopolies shall still be maintained

- Inter-exchange operations: Competition will be limited to two players.

- International services: Franchises will be granted only to those with pre-arranged or prospective correspondent or interconnection relationship with major overseas telecommunications authorities or carriers.

- Cellular radio services: Telephone exchange areas with at least 50,000 subscribers will be opened to competition without need for a franchise. Operators, however, are still required to register with the NTC and comply with norms on radio spectrum utilization.

Government's goal to expand basic telephone service coverage at reasonable rates, however, leads to a policy of limited competition in long distance services at least until expansion is deemed satisfactory. As stated in the NTDP, the government recognizes the importance of preserving the toll-to-local subsidy flows to finance local service expansion. Thus, during the expansion phase, government would avoid unnecessary duplication of long-distance facilities nor destructive competition in the provision of such service that would threaten the subsidy.

The principles of natural monopoly and the stated public policy of subsidizing local telephone service from toll service in order to reach maximum development of the system are arguments against allowing full, unhampered competition in the telecommunications sector.

Technological advances, particularly the advent of digital technology which allow the provision of all types of services using a single line, also serve to make the argument for greater competition an open-ended issue. Should there be a single provider of all telecommunications services or should there be open competition?

Such situations favor PLDT because it has protected its position not only by keeping pace with technological advances such as ISDN but also by making certain of getting a franchise to use such technology.[3]

Regulatory agencies still have to find the correct balance between fostering natural monopolies (to preserve scale economies) and promoting competition (to enhance consumer welfare). New sets of rules must be developed and enforced by the regulator. The policy uncertainty can only favor PLDT as the incumbent, notwithstanding the trend towards greater competition.

[3] The 25-year franchise was granted through Republic Act 7082 which took effect last August 24, 1991. It expanded PLDT's existing franchise (R.A. 6146) to include other value-added services such as ". . . .data, facsimile, control signals, audio and video transmissions, information service bureau and all other telecommunications systems technologies as are at present available or be made available through technological advances or innovations in the future."

Additional Policy/Recommendation

In summary, the Study Team proposes the recommendations below according to the following order of priority.

Strengthening of the NTC

To ensure that policies and regulations are undertaken effectively, a strong and technically capable regulatory agency is needed. The NTC, as noted in the NTDP, is seriously understaffed and ill-equipped to deal with emerging complex issues. Thus, the strengthening of the NTC should be given top priority.

- A bill reorganizing and strengthening the NTC, similar to House Bill (HB) No. 30565, should be filed in the next Congress. HB No. 30565 "Reorganizing the National Telecommunications Commission and Appropriating Funds Therefor" called for the strengthening of NTC's regulatory functions. The bill proposed the creation of a collegial decision making body and the addition of the much needed staff resources. The bill also proposed to broaden the responsibility of NTC's regulatory function to cover all public networks, i.e., both government and private-owned facilities.

- To ensure compliance by carriers with service commitments, the NTC should strictly impose sanctions for non-compliance. The existing sanctions, which were based on outdated legislation, appear ineffective and need revisions. The NTC should also be given more power to impose these sanctions. This could be achieved by incorporating in the proposed bill on NTC strenghtening the power to take over the facilities of carriers whose performance is unsatisfactory and assign these facilities to other carriers. This provision was also included in HB 30565.

- The NTC needs a more proactive assessment of such areas as rate of return regulation and rate structures currently being employed by telephone and record carriers. To upgrade the capability of NTC staff, technical assistance is needed particularly in the areas of rate setting, interconnection, development of performance standards, and monitoring of performance.

- Many telecommunications operators do not comply with the NTC requirement to submit annual financial statements which serve as basis for monitoring their financial conditions and evaluating requested rate adjustments. Among the reasons for non-compliance, as cited in the NTDP, are the lack of clear understanding of the reporting requirements and the lack of a uniform system of accounts that will generate the necessary data. Thus, the NTC needs assistance in developing financial as well as operating standards and establishing a system that will effectively monitor operators' performance.

Opening telecommunications development to greater competition

Government regulators should foster telecommunications infrastructure development via the workings of a competitive marketplace. A competitive environment offers telecommunications providers a powerful set of market-driven incentives to make efficient investment decisions.

- This means the government should reexamine the natural monopoly rationale and differentiate basic telephone services from enhanced, value-added network services. [4] Technology advances have created new services which cannot easily fit existing regulatory schemes.

- In certain market segments where competition is found desirable such as in value added services, the government should encourage and facilitate competitive entry by multiple providers. This is to give end-users advanced services at competitive rates.

- For the basic traditional telephone services where monopolies based on geographic areas were found to be desirable, government regulators should strengthen implementation of mandatory interconnection. The process of arriving at interconnection agreements and resolution of conflicts arising from such arrangements should be facilitated. In the past, mandatory interconnection has stalled due to disagreements on revenue sharing mechanisms.

- In segments opened to competition, government regulators should monitor the degree of market power of players in these new segments and restrict collusionary or exclusionary activities such as buyouts, mergers, and other unfair practices that will restrict access.

Reform of the pricing policies

To ensure that entry is economically efficient, pricing policies have to be reformed. This will entail deregulating or allowing significant pricing flexibility for services that face competition.

- There may be a need to review the existing procedures for rate setting. Although revisions to the 12 percent rate of return have been proposed by the NTDP and pending bills, an alternative to rate of return regulation may also be studied.

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[4] Value added network services (VANS) refer to many services that combine telecommunications with an additional service that enhance the information transmitted. Value-added carriers (companies that provide VANS) do not build their own long-distance lines but lease lines from a telephone company and using their own equipment, add services not available from the telephone company.

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- In many parts of the world, there have been growing concern about the inefficiencies and imperfections associated with rate of return regulation. This led regulatory agencies to abandon it in favor of so-called "incentive" regulation which seeks to create incentives that spur regulated firms to become more efficient than is commonly the case under the rate of return regulation.

- One of the more popular types of alternative regulation being undertaken in the US is "price cap" regulation which seeks to control prices, rather than profits, by limiting increases in regulated rates according to a formula that reflects the costs of providing regulated services and productivity gains.

Research Areas

For prospective research studies on telecommunications related to the central themes of the engagement, the following may be undertaken:

- In cases where competition within the market is not possible, allowing competition for the market should be undertaken. This is the so-called Demsetz competition. A concrete example of competition for the market is the failed bidding for the privatization of telecommunications facilities in Regions 1 and 2. Given the issues arising from certain bidding rules, a rebidding has been ordered by the DOTC. An assessment of the current bidding/privatization guidelines and procedures, and the controversies arising therefrom and subsequent developments may be undertaken as a case study to examine lessons and propose corrective measures to facilitate competitive entry into the market.

- An in-depth study of the effects of entry barriers on the performance of telecommunications industry as a whole and on the welfare of users. Although there have been some indicators of the impact of entry barriers, there has been limited to the telephone services. There is a need to do a more comprehensive assessment for the entire telecommunications industry. The results can guide policymakers in instituting changes in the regulatory environment for the industry.

- Determination of market segments where competition may already be allowed. While a natural monopoly may be justified in certain segments, the presence of competition might be desirable in others. The technological advancements in the field have created additional services which can be efficiently provided under a competitive market. In this regard, a review of the natural monopoly argument for telecommunications needs to be undertaken.

II MANUFACTURE OF MANMADE FIBER

BACKGROUND

Definition of the Industry

Manmade fibers (or chemical fibers) are manufactured from natural fibrous materials or from a synthesis of chemicals. Accordingly, they are classified as: cellulosic (e.g. rayon acetate and triacetate), oil-based (e.g. nylon, polyester, acrylic, modacrylic, olefin, saran, spandex, rubber), mineral (e.g. glass, metallic) and minor oil-based (e.g. vinylon, vinal, azlon, nytril, azlon, etc.).

The manmade fiber industry of the country is capable of producing three basic products: polyester, nylon and rayon. Currently, there are only four companies identified with the industry with one or two firms dominating a particular segment that conforms to a basic product offering.

This study focuses on the polyester manufacturing subsector. At present, there is only one polyester manufacturing company in the country, the Filipinas Synthetic Fiber Corporation, now known as Filsyn Corporation.

Emergence of the Industry

The industry traces its roots to the introduction during the early 1960s of American sport shirts called "Banlon", a form of acrylic fiber. Because of its prohibitive cost, substitute products were developed by the Japanese and were manufactured locally; thus, followed the introduction of acrylic shirts such as the "Vonnel", "Cashmilon" and "Exlan".

The popularity of acrylic shirts, however, waned in the late 1960s due to its incompatibility with the local climate. During that same period, polyester fibers and fabrics became the worldwide trend. Its inherent characteristic of being crease-resistant caught everyone's fancy that Philippine importation increased substantially. Such development prompted three of the biggest integrated mills (i.e., Utex, Artex, and Gentex) to combine resources and organize, the first polyester manufacturing firm, Filsyn, in 1969.

In 1972, the BOI approved and registered the organization of another polyester plant proposed by Riverside Textile Mills (the country's biggest textile mill in terms of capacity) under the Lakeview Industrial Corporation. As with Filsyn, Lakeview sourced its raw materials from Japan.

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The foreign exchange crisis in the mid-1980s and the attendant trade restriction policies resulted in a shakedown in the industry that is heavily dependent on imported raw materials. Lakeview was foreclosed by the Development Bank of the Philippines (DBP) and in 1983, Filsyn acquired the plant assets and outstanding stock of the company from the DBP (through the National Development Corporation) for ₱ 110 million, payable in cash and in common shares of stock of Filsyn. This development, in effect, made Filsyn the lone polyester manufacturer in the country.

The Product and Its Uses

Polyester is a manufactured fiber in which the fiber forming substance is any long chain synthetic polymer composed of at least 85 percent by weight of an ester of a dehydric alcohol and terephthalic acid.

The product has gained wide usage because of its favorable characteristics, among which are: (a) its excellent resiliency or the ability to spring back to its original form; (b) after being treated with permanent press, polyester used as a blend fiber, becomes wrinkle resistant; and (c) it is a lightweight yet strong fiber that resists abrasion.

Polyester is often blended with other fibers such as cotton, ramie, silk, wool and has been accepted by Filipino consumers. Many of the permanent-press fabrics are made by blending polyester and resin-treated cotton. Its excellent resiliency makes it suitable for such uses.

Polyester and its blend find most frequent application in wearing apparel. Other uses are in draperies, carpets, sheets, and pillow cases for home use. Polyester in the form of fiberfill is often used as stuffing materials for brassieres, pillows, comforters or mattresses. Industrial uses of polyester include fire hoses, power belting, ropes and nets, tie cords for automotive uses and sails for sports.

The Manufacturing Process

The major inputs in the production of polyester fibers are demethyl terephthalate (DMT) and ethylene glycol (EG). These two are petrochemical derivatives. Other inputs are catalysts, delusterants and stabilizers.

There are two common processes that may be applied to the manufacture of chemical fibers. These are: a) transesterification reaction procedure using DMT and EG; and b) direct esterification reaction method using terephthalic acid (TPA) and ethylene oxide. Filsyn (and Lakeview) uses the first procedure which is believed to be the traditional method.

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Polymer manufacture using the traditional method is initiated with the exchange of glycol groups from ethylene to DMT to form glycol terephthalate. Methanol is then lubricated and removed by distillation. The glycol terephthalate is immediately discharged to the polymerization reaction where catalysts and delustering agents are added. Polymerization reaction proceeds with the liberation of glycol which is then recovered for use in the transesterification reaction. The molten polymer is then extended in ribbon form, cooled by water, cut into chips and stored. The production of the intermediate product is done primarily to allow for greater production flexibility.

Polyester fibers are melt-spun like polyamide (or nylon) fibers. In producing staple fibers, the polyester chips are dried to a desired moisture content and transformed into a fluid state. They are then forced through spinnerets which have minute orifices to come out in long filament form. After cooling and solidification in a quenching chamber, the filament strands are mechanically arranged inside large tow cans. This is then stored for a couple of days before it is stretched. Once stretched, the filament strand is passed through a crimping machine where it is given the property of "waviness". The wavy yarn is then processed in a setting machine to make permanent "waves". The yarn is finally cut into uniform lengths and is ready for shipment.

To make the filament yarn, the cooled and solidified elements are pulled by take-up rolls running at high speed and wound up into large cylindrical packages. The spinning process produces yarns with very low tensile strength and wide elongation range. For final use by textile mills, the yarns are draw-twisted to attain the required tenacity and elongation.

Technology

Technology and know-how adopted by the industry are, for the most part, borrowed. Technology transfer was mainly effected during the tie-up stage in the case of Filsyn (with Teijin Ltd. of Japan) and Lakeview Industrial (with Chemtex of the U.S.).

Through the years, the industry made appropriate modifications/adjustments to reflect local operating conditions. Filsyn embarked on a modernization and technology upgrading program to enable them to cope with recent technological developments. In early 1991, the BOI approved Filsyn's expansion project under a pioneer status. The project will be utilizing the "continuous" process, a relatively new technology. Under this production process, polyester will be manufactured direct from the polymerization stage to the spinning stage. By doing away with the existing intermediate stages, this new technology will prove to be energy-saving for the company.

Raw Materials

The basic raw materials used in the production of polyester are petrochemical derivatives. Inasmuch as the country has no petrochemical industry it is currently wholly dependent on foreign sources for its oil-based and petrochemical requirements. Major suppliers of such imports are Japan, the Middle East and the U.S. A report submitted by the Joaquin Cunanan and Co. to the BOI (1988 Data Base Compilation Covering the Chemical Fibers Subsector) cites that the imported component of direct raw materials cost of the industry accounts for 96-100 percent of the total.

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Machinery and Equipment

The industry is highly capital-intensive. The extensive use of capital equipment is understandable considering that the industry fundamentally involves chemical processing. Table 2.1 shows the machinery and equipment line-up of Lakeview and Filsyn. Filsyn's investment in machinery and equipment amounted to ₱ 1.3 billion in 1991.

Table 2.1
Machinery and Equipment Line-Up

A. Filsyn

1. Polymerization
   - Glycol recovery
   - Tank yard
   - DMT smelter
   - Polymerization
   - Auxiliary
   - Chip Handling
   - Analysis device
   - Main Piping Material
   - Electrical and Instrumentations

2. Staple Fiber Spinning
   - Chip conveyor
   - Chip drying
   - Spinning
   - Take-off
   - Air conditioner
   - Packing Facilities
   - Piping
   - Electrical and Instrumentation

3. Staple Fiber Drawing
   - Creel
   - Drawing
   - Crimping
   - Dry Setting
   - Cutter
   - Baling
   - Air Conditioning
   - Piping
   - Electrical and Instrumentations

4. Utility Equipment
   - Power Service Equipment
   - Diesel engine
   - Power distributor
   - Electrical equipment power station
   - Steam generator
   - Nitrogen generator
   - Air compressor
   - Water treatment machine

B. Lakeview

1. Chemical Plant
   - Esterification
   - Poly condensation
   - Chips Production
   - Chips drying
   - Dowtherm heating plant

2. Spinning section
   - Spinning equipment and accessories

3. Draw twisting section
   - Draw twister and accessories

4. Chemical laboratory

5. Textile Laboratory

6. Air Conditioning

7. Refrigeration Plant

8. Nitrogen Plant

9. Plant for Demineralized Water

Source: Progress Report on BOI Sectoral Dev't. Program Phase II-Data Base Compilation Covering the Chemical Fibers Subsector by Joaquin Cunanan & Co., 1988.

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INDUSTRY STRUCTURE

As previously mentioned, the industry started out with two competing firms. However, developments in the mid 1980s that resulted in the acquisition of Lakeview by Filsyn, made the latter the sole manufacturer of polyester in the country today. The only competition to Filsyn comes from imports of polyester fibers. Until 1987, however, the government suppressed competition by restricting the importation of polyester.

Industry Participants

Lakeview Industrial Corporation

Lakeview Industrial Corporation was incorporated as Republic Rayon in 1959 and amended its present corporate name in 1968. In 1972, Lakeview was registered with the BOI under R.A. 5186 as a pioneer enterprise for the manufacture of polyester staple fiber and filament yarn.

Lakeview was originally a joint venture of the Tanchi Group of Companies and Chemtex Fibers, Inc., a foreign company specializing in the design, engineering, erection and operation of plants to produce manmade fibers and films.

The importation of Lakeview's machinery and equipment was financed principally through loans with the Export-Import Bank of the United States, Equibank N.A.,and Chemtex Fibers, Inc., all guaranteed by the Development Bank of the Philippines. In addition, Asia Pacific Capital Corporation (APCO) granted a loan, guaranteed by the Manila Banking Corporation, to finance the civil works and auxiliary equipment.

The start-up operation of the plant in 1976 was attended by several problems which delayed commercial operations. These problems included defective and incomplete machinery and equipment, failure to meet production targets, poor quality, power failure and fluctuations due to lack of a generator, as well as lack of sufficient working capital to procure raw materials and spare parts.

Partial operations started in 1977 while commercial operations began in 1978. However, technical problems continued to beseige the plant, resulting in low productivity and unacceptable product quality. During the period 1978 to 1981, capacity utilization was only about 55 percent to 75 percent due to technical problems, unstable power supply and lack of materials and parts.

Efforts were geared to solve the plant's technical problems in 1979 and 1980. Toyobo, one of the leading polyester manufacturers in Japan, was brought in to modify the plant in 1980 at a cost of ₱ 45 million. Although some improvements were experienced, the targets on productivity and quality were not attained.

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Due to technical and financial difficulties, DBP had to foreclose Lakeview. In 1979, the DBP acquired the assets of Lakeview under a "Dacion en Pago" arrangement. In 1981, Filsyn agreed to manage, supervise and improve the operations of Lakeview. In consideration for these services, Filsyn was entitled to a certain management fee. In 1982, the plant was completely shut down due to poor market conditions and Filsyn engineers overhauled, repaired and improved the plant facilities. During this time, negotiations were conducted between the government and Filsyn for the latter to acquire Lakeview Industrial Corporation.

The acquisition of Lakeview by Filsyn was a move that was initiated and pursued by the government in line with its objectives to enhance the efficiency and viability of the industry and optimize the cost of manufacturing polyester fiber, a major raw material for the textile industry.

Currently, Lakeview is recognized as a subsidiary of Filsyn Corporation. Its plant assets are carried in Filsyn's books. It serves as a service contractor, manufacturing polyester fibers using raw materials provided by Filsyn.

Filsyn Corporation

Filsyn Corporation is primarily engaged in the manufacture of polyester fiber and yarns. It was incorporated on July 22, 1968 as a joint Filipino-Japanese venture. The Japanese end of the joint venture was represented by Teijin Ltd. The latter executed a License and Technical Assistance Agreement with Filsyn in November 1969 binding itself to render all its patents, licenses, design, formulae and product development necessary to produce premium quality polyester fiber. Since it belonged to one of the "promoted" industries, Filsyn was able to borrow from DBP to finance the importation of its machineries. Moreover, Filsyn was able to secure loans from foreign sources such as IFC and APCO. Loans due foreign suppliers were guaranteed by the DBP. Such guarantees were collateralized by a mortgage of the Company's buildings, improvements, machinery and equipment.

Filsyn registered with the BOI under a preferred pioneer status as a producer of polyester fibers, filament yarns, and bottle grade polyethylene terephthalate resin (starting 1985) under R.A. 5186. The BOI also granted the company a license to operate as a Registered Export Trading Co. Filsyn's entry into the export market in 1984 was triggered by the weak domestic demand during the period. Aside from polyester yarn (filament yarn, waste yarn and textured yarn), Filsyn also exports other products such as pure terephthalic acid, ropes, carpets, processed fruits and ladies' hats.

In the early 1980s, Filsyn requested for the extension of its tax exemption incentives as provided by P.D. 1584. The request was granted by the BOI subject to certain conditions, notably the acquisition by Filsyn of the Lakeview Industrial Corporation and the expansion of the company to an economic world-size unit. In November 1982, Filsyn, DBP and NDC executed an agreement whereby DBP will transfer to Filsyn, through the National Development Company, all plant assets and outstanding capital stock of Lakeview for ₱110 million payable in cash (₱50 M) and in common shares of Filsyn (₱60 M). Pending the finalization of the acquisition, DBP waived its rights and interests to the Lakeview plant assets in favor of Filsyn.

In 1984, Filsyn's joint venture partner pulled out, claiming that it needed funds to undertake a large scale program to manufacture novel polyester-based products in Japan. The withdrawal had no adverse effect on the company, as Teijin was considered to be more of a technical partner than a financier. In 1989, Filsyn entered into an agreement with Far Eastern Textile Ltd.of Taiwan, reputed to be the fourth largest manufacturer of polyester in the world. The agreement involved investment by the Taiwanese firm as well as technical assistance and marketing support.

Market Demand and Supply

Demand

Demand for polyester is linked up with the demand for textile fabrics. Generally, it has been found that 50 percent to 65 percent of polyester fiber is needed in a fabric blend to bring out its best qualities. The increased preference for polyester as a major fiber blend for textile fabrics is due to its comparatively lower price vis-a-vis cotton. Moreover, textile manufacturers agree that there is less wastage in the use of polyester fiber as compared to cotton. Table 2.2 shows the estimated consumption of polyester fiber for 1980-1990 expressed as the sum of local sales and imports. Demand in the last three years ranged between 32 thousand metric tons to 40 thousand metric tons.

Table 2.2
Estimated Historical Demand for Polyester Fiber
(In Metric Tons)

Year	(Sales)	(Imports)	(Total)
1980	11,442	2,473	13,915
1981	12,695	9,625	22,320
1982	7,282	7,155	14,437
1983	18,970	5,052	24,022
1984	15,684	4,379	20,063
1985	18,970	4,358	17,883
1986	12,959	8,702	21,661
1987	16,818	12,657	29,475
1988	16,095	17,600	33,695
1989	15,235	17,162	32,397
1990	16,682	22,888	39,570

Source: Joaquin Cunanan & Co., 1990.

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Supply

Supply of polyester fiber was sourced from local production and imports. Data for the years 1980-1990 are given in Table 2.3.

The increased domestic production over the years is attributed to the increase in plant capacity. The abrupt increase in production from 1982 to 1983 is due to the acquisition by Filsyn of the temporarily closed Lakeview facilities. On the other hand, the decline in production from 1985 to 1987 and 1990 may be explained by work slowdown due to labor-related problems encountered by Filsyn during these years.

Any excess demand is met by importation. The liberalization of polyester importations led to the notable increase in import volume during the last three years. Taiwan has been the major source of imports, accounting for at least 70 percent of total import volume during the last five years.

Table 2.3
Sources of Supply of Polyester Fiber

Year	Production (in MT)	Imports (in MT)
1980	11,197	2,473
1981	12,930	9,626
1982	7,886	7,155
1983	18,880	5,053
1984	18,714	4,379
1985	11,374	4,358
1986	15,316	8,702
1987	14,714	12,657
1988	18,907	17,600
1989	18,092	17,162
1990	10,693	22,888

Sources: a) Filsyn Annual Reports, various years.
b) NSO, Foreign Trade Statistics of the Philippines, various years.

Prices

Local polyester prices have often been the subject of rows between textile millers and Filsyn most especially in the mid 1980s when importation of polyester fibers had to be authorized by the BOI. During that time, textile millers clamored for polyester prices that were more reflective of world market prices. Textile millers specifically batted for the adoption of a pricing formula similar to the formula for cotton prices that is based on landed cost of imported cotton.

Table 2.4 presents a comparison of average per kilogram prices of local and imported polyester fiber for the last decade. It is noted that even with a 30 percent tariff protection, the average prices of local polyester fiber was still higher than its imported counterpart, most especially during the mid-1980s.

With the liberalization of polyester importations and the lowering of protective tariff, the industry strove to compete with imported polyester prices. A narrowing of the price differential between imported and domestically produced polyester was observed during the latter part of the decade, due in part to the devaluation of the peso and the adoption by the industry of cost reduction programs..In 1990, the price of imported polyester fiber inclusive of the 20 percent tariff already exceeded the domestic price. Given the reduction of the tariff rate to 15 percent in mid-1991, domestically produced and imported polyester fiber must have comparable prices.

Table 2.4
Comparative Staple Polyester Fiber Prices

	Local Price (₱/kg)	CIF Value U.S. $ a/	Peso Equiv. b /	Landed Cost Equiv. at 30% Tariff Rate c /
1980	16.45	1.67	12.54	16.30
1981	20.15	1.76	13.90	18.08
1982	19.11	1.66	14.18	18.43
1983	23.03	1.22	13.56	17.63
1984	41.50	1.25	23.38	30.39
1985	41.99	1.25	23.26	30.24
1986	44.80	1.12	22.84	29.69
1987	40.05	1.18	24.27	31.55
1988	39.58	1.30	27.42	32.91
1989	46.23	1.70	36.95	44.43
1990	33.37	1.27	30.87	37.05

a_/ Average price based on data from Foreign Trade Statistics of the Philippines

b_/ Conversion to peso equivalent based on average exchange rate for the year

c_/ Tariff rate of 30 percent from 1980 to 1987; 20 percent for 1988 to 1990

Source: Board of Investments (BOI).

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Performance of Key Participants

Ownership Structure

Table 2.5 shows the present structure of ownership of Filsyn Corporation.

Table 2.5
Ownership Structure of Filsyn Corporation

Nationality	No. of shares	Amount	Percent
Filipino	92,978,477	₱ 464,892,385	60.00
Foreign	61,985,653	309,928,265	40.00
Bermuda	45,065,670	225,328,350	29.08
American	12,913,679	64,568,395	8.33
Japanese	3,006,304	15,031,520	1.94
Chinese	800,000	4,000,000	0.52
Canadian	200,000	1,000,000	0.13
Total	154,964,130	774,820,650	100.00

Source: Securities and Exchange Commission.

Notable among the stockholders of Filsyn are the U.S. based Amoco Company and the Far Eastern Textile Ltd. of Taiwan (which is actually Bermuda-based). Amoco Company is the largest producer of purified TPA, a major raw material for the manufacture of polyester. This company is the principal supplier of Filsyn's raw material requirements.

The investment of Far Eastern Textile Ltd. in 1989 enabled Filsyn to push through with its modernization and expansion program aimed at increasing production efficiency and upgrading product quality.

Production Capacity

Filsyn started commercial operation with an initial rated capacity of 5,000 metric tons (MT) per year. Latest data indicate that total rated capacity has reached 36,000 MT per year of which 60 percent is accounted for by staple fiber production. Historical plant utilization has hovered between 60 to 80 percent. However, plant utilization in 1990 was severely affected by the shutdown of Filsyn's Sta. Rosa plant. The Filsyn plant in Laguna is equipped with machinery for polymerization, chip storage and drying, polyester spinning and drawing and methanol recovery.

Given the present capacity and plant utilization, it seems that Filsyn is unable to meet domestic demand. This could be a signal for greater liberalization of the industry.

Financial Performance of FILSYN

The first few years of operations have been profitable for Filsyn. The company started to experience financial difficulties starting in 1980, although it is observed that Filsyn performed quite well during the crisis years 1983-1984 (see Table 2.6). Profits started to decline starting in 1987 due to labor problems in the company's polyester plants which resulted in low productivity and higher unit costs. The worsening of Filsyn's financial position in 1988 to 1990 had been the result of several factors, among which were the reduction in the protective tariff on polyester, the liberalization of imports and labor-related problems that remained unresolved during the second half of the 1990.

As part of its corporate strategy, the company has embarked on a diversification program aimed at providing additional sources of revenue. Among the projects under the program are the manufacture of polyethylene (PET) resins and the recently approved manufacture of PET bottles.

Industry Issues

During the past two decades, a number of issues or problems have surfaced which were considered to have had a significant impact on the performance and growth of the industry. Among these issues are:

Classification of Polyester Manufacturing in the IPP

This issue arose during the late 1980's and involved the entry of a foreign firm, E-Hsin International Corporation of Taiwan. The controversy started when the Taiwanese firm applied for a pioneer status with the BOI. In justifying its application, E-Hsin cited that it would be introducing a new technology called the "continuous process." During that time, polyester manufacturing was listed as "Non-Pioneer" under the Investment Priorities Plan. The Board of Investment, however, was considering the reclassification of polyester to "Pioneer/Non- Pioneer" in the IPP in order to accommodate the Taiwanese project.

In May 1989, Filsyn submitted its position paper to the BOI, manifesting its strong objection to the grant of pioneer status to the E-Hsin project. Filsyn argued that the Taiwanese project did not merit a pioneer status inasmuch as polyester fiber manufacturing has already been pursued in the country for a number of years. Moreover, it argued that the continuous process could not be considered as "entirely novel" in the country nor is it "substantially better" than the existing technology.

After evaluation, the BOI decided to grant the project a pioneer status citing that by introducing a new technology the project met the BOI's criteria.

Filsyn appealed the decision to the Office of the President which subsequently upheld the BOI's decision. Filsyn brought the case to the Supreme Court. The case, however, was dismissed in late 1990 after Filsyn decided to withdraw its petition. The Taiwanese firm had, by then, already decided not to push through with their project due to unstable power supply and political instability following the December 1989 coup attempt.

Table 2.6
Filsyn Corporation
Financial Highlights
(in P '000)

	1974	1975	1976	1977	1978	1979	1980	1981	1982
NET SALES	178,851	208,652	274,402	328,981	318,391	281,561	348,305	515,158	423,204
NET INCOME	55,151	59,622	5,012	27,420	39,377	34,507	(3,302)	9,516	(17,885)
TOTAL ASSETS	375,588	509,061	526,189	515,028	532,976	759,763	846,482	808,627	894,003
TOTAL LIABILITIES	258,202	366,297	382,745	352,828	352,370	556,065	589,576	603,195	646,535
TOTAL EQUITY	117,386	142,764	143,444	162,200	180,606	203,678	256,906	205,432	247,548
FIXED ASSETS	n.a.	n.a.	n.a.	267,815	245,169	395,077	459,742	361,713	452,528
RATIO OF FIXED ASSETS TO TOTAL ASSETS	n.a.	n.a.	n.a.	0.52	0.46	0.52	0.54	0.45	0.51
CURRENT ASSETS/CURRENT LIABILITIES	1.48	1.43	1.34	1.47	1.47	1.25	1.19	1.12	1.24
INCOME/ASSETS (%)	14.68	11.71	0.95	5.32	7.39	4.54	(0.39)	1.18	(2.00)
INCOME/SALES (%)	30.84	28.57	1.83	8.33	12.37	12.26	(0.95)	1.85	(4.23)
INCOME/EQUITY (%)	46.98	41.76	3.49	16.91	21.80	16.94	(1.29)	4.63	(7.22)
DEBT-EQUITY RATIO	2.20	2.57	2.67	2.18	1.95	2.73	2.29	2.94	2.61
TOTAL LIABILITIES/ TOTAL ASSETS	0.69	0.72	0.73	0.69	0.66	0.73	0.70	0.75	0.72
EQUITY/ASSETS	0.31	0.28	0.27	0.31	0.34	0.27	0.30	0.25	0.28

	1983	1984	1985	1986	1987	1988	1989	1990
NET SALES	806,224	1,287,917	1,365,450	1,268,086	1,494,627	1,206,925	1,187,687	1,045,741
NET INCOME	32,894	52,759	(68,937)	41,427	27,388	(133,866)	(249,219)	(385,767)
TOTAL ASSETS	1,175,260	1,481,371	1,445,266	1,560,438	1,604,386	1,753,460	1,587,534	1,687,654
TOTAL LIABILITIES	894,819	1,148,171	1,181,003	1,072,640	1,124,784	1,391,174	950,393	1,137,362
TOTAL EQUITY	280,441	333,200	264,263	487,798	479,602	362,286	637,141	550,291
FIXED ASSETS	661,960	756,943	672,730	882,717	851,215	827,477	764,705	972,891
RATIO OF FIXED ASSETS TO TOTAL ASSETS	0.56	0.51	0.47	0.57	0.53	0.47	0.48	0.58
CURRENT ASSETS/CURRENT LIABILITIES	1.33	1.26	0.92	1.11	1.00	0.87	0.90	0.61
INCOME/ASSETS (%)	2.80	3.56	(4.77)	2.65	1.71	(7.63)	(15.70)	(22.86)
INCOME/SALES (%)	4.08	4.10	(5.05)	3.27	1.83	(11.09)	(20.98)	(36.89)
INCOME/EQUITY (%)	11.73	15.83	(26.09)	8.49	5.71	(36.95)	(39.12)	(70.10)
DEBT-EQUITY RATIO	3.19	3.45	4.47	2.20	2.35	3.84	1.49	2.07
TOTAL LIABILITIES/ TOTAL ASSETS	0.76	0.78	0.82	0.69	0.70	0.79	0.60	0.67
EQUITY/ASSETS	0.24	0.22	0.18	0.31	0.30	0.21	0.40	0.33

Source: Business Day's Top 1000 Corporations in the Phil.

Poor Equipment and Facilities

The industry suffered from inefficiencies from the use of inadequate or defective machinery. This was true during the early years of the industry, particularly in the case of Lakeview Industrial Corporation, whose failure was attributed mainly to technical problems due to the acquisition of inadequate machinery.

Unstable Power Supply and High Cost of Power

The polyester manufacturing process is highly energy intensive. The unstable supply of power has caused inconvenient disruptions in the manufacturing process which consequently result in poor product quality. Moreover, the high cost of power makes it hard for Filsyn to compete with the prices of polyester imports.

Smuggling

Rampant smuggling of polyester fiber and yarns has been experienced by the industry. In a survey conducted by the Joaquin Cunanan and Co. in 1987, Filsyn stated that technical smuggling eats up about 30-50 percent of potential sales for the company. With the liberalization of imports, the industry fears that the continued smuggling of polyester will hamper the growth of the local industry.

Policy and Regulatory Framework

Support for the industry comes in the form of incentives for BOI-registered firms. With its registration with the BOI as a preferred pioneer enterprise for the manufacture of polyester fiber, Filsyn was entitled to tax and non-tax incentives such as tax exemptions on imported capital equipment, accelerated depreciation, exemption from all taxes except income tax and post-operative tariff protection.

Government protection has also been provided for the industry in the form of restrictions in the importation of polyester fiber. The importation of polyester fiber was regulated under CB Circular 1089 of 1984 which required importers to seek prior approval of the BOI, which in turn consulted Filsyn regarding its readiness to supply the additional demand. Textile millers had been required to buy their polyester requirements from Filsyn.

In the mid-1980s the industry enjoyed an effective tariff protection of 30 percent. A program of tariff reforms by the Aquino government has, since then, lowered the tariff on polyester fibers to 20 percent in 1987 and to 15 percent at present.

Under the government's import liberalization program, the importation of polyester staple fiber and filament yarn was liberalized effective November 1987 and January 1988, respectively. This development, in effect, places Filsyn in a more competitive environment.

GENERAL ASSESSMENT

Emergence of Entry Barriers

The polyester subsector is a strategic industry in the sense that its products are key inputs to the textile industry. Its efficiency/inefficiency will immediately be transmitted to the textile industry. The government policy was to develop the industry and protect it during its infancy through quantitative restriction and high tariff walls. Due to the underdeveloped capital market in the Philippines, the government through its own financial institution, DBP, stepped in to provide cheaper long-term funds to participants of the industry. Since the industry is heavily dependent on imported raw materials and is an import-substituting one, it was clearly vulnerable to foreign exchange crisis. Thus, one of them folded up when the economy encountered a foreign exchange crisis in the mid-1980s.

The availability of cheap credit from DBP to the pioneer firms in the industry serves as a formidable entry barrier especially since there is virtually no capital market in the country. Competition from imports was muted by the quantitative restriction and high tariff rates that were in place for more than 15 years. The BOI incentives to incumbents reinforced existing entry barriers. The first two entrants enjoyed fiscal incentives as preferred pioneer industries, which was later on reverted to non-pioneer status. This means that new entrants will have to contend themselves with less fiscal incentives, thereby increasing their entry cost relative to those of the first two entrants. The recent decision of BOI to give the industry a pioneer/non-pioneer status so that a new entrant could come in was challenged by the incumbent in court, suggesting that any BOI decision lacks finality. Unclear authority of the regulatory agency gives rise to entry barrier. Were it clearly known to every body that any decision of BOI with respect to classifying industries as pioneer and non-pioneer is final, the potential entrant could have already entered the market and started competing with the incumbent.

There is no doubt therefore that entry barrier in this sector has been caused by government policy.

Impact on the Economy

On the Users

As pointed out above, local textile millers had been required to purchase polyester fiber from Filsyn. They could not import this raw material unless they obtain an import authority from the BOI. They have, therefore, borne the brunt of Filsyn's high production cost and inefficiency. This, together with the high energy cost, made their products uncompetitive. Domestic consumers ultimately had to pay higher prices for polyester-based products. A further damaging effect of high domestic prices of polyester is that manufacturers have been limited to the domestic market since domestic textiles have not been used in the garments sector industry, which is an export-oriented sector. The garments sector has, therefore, very low value added.

On the Incumbent Firm

The protection and incentives given by the government to the incumbent had not been insignificant. As mentioned above, the quantitative restriction imposed on imports of polyester fiber had been accompanied by high tariff rates. Since Filsyn had a captured market, which was formalized by government regulation through the BOI, it had no motivation to become competitive. Mercado (1987) noted that "the firm may not survive a 20 to 30 percent tariff scenario. It has no comparative advantage in the production of staple fiber as proven by its DRC figures both at reported capacity and at 100 percent capacity" (p. 98). Indeed, when importation of polyester was liberalized in 1987, Filsyn incurred losses starting in 1988. This suggests that the profits enjoyed by Filsyn in the past years had been due to the protection accorded it by the government.

On the Competitors

The incumbent firm will have to deal with two types of direct competitors. The first is a manufacturer, which to date remains as a potential entrant. As long as BOI incentives are made available to industries included in its Investment Priority Plan, the potential entrant will naturally exert pressure on the government to include in the IPP this sector as a pioneer industry. The tax exemption will definitely be a large factor in enabling it to compete with the incumbent. On the other hand, scrapping altogether this sector from the IPP confers certain advantages to the incumbent. Levelling the playing field in this area is indeed a big challenge to the government.

The potential entrant will also have to consider the problem of what to do with excess capacity. If the new entrant will put a plant with the same capacity as Filsyn, the industry will immediately experience a large excess capacity. Export competitiveness will therefore play a big factor for the new entrant.

The other type of competitor consists of traders who import polyester fiber. With the import liberalization, their main concern would be to raise capital to undertake importation. They will be highly competitive as long as the domestic currency remains overvalued.

Policy Directions

The outright dismantling of the polyester fiber monopoly to get rid of the downstream burden has been suggested by Mercado (1987). Opening up the field to new entrants, however, is not a simple matter as seen in the E-Hsin case. The objective of policy must be focused less on dismantling the monopoly in the man-made fiber industry but more on making it world competitive in view of its importance to the downstream industries that include the export-oriented garments sector.

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There are at least three measures that could be done to attain this objective. First, reforms -- liberalization of imports and tariff cuts -- must be sustained. Textiles is included among the 15 groups of products scheduled for tariff reduction under the Common Effective Preferential Tariff (CEPT) designed to set up an Asean Free Trade Area (AFTA) within 15 years. Of course, this must be accompanied by a policy that seeks to establish a realistic foreign exchange. The presently overvalued domestic currency could not make Filsyn competitive both in the domestic and world markets. Second, fiscal incentives given to Filsyn must be eliminated, if not substantially reduced, and man-made fiber must altogether be taken away from the IPP list. Third, foreign investment must be encouraged in this sector. The recently promulgated Foreign Investments Act is a step towards this direction. Efforts should be exerted not to include this industry in List C of the regular negative list nor in the list of strategic industries in which foreign participation is limited. These three measures could make the industry a contestable market.

Having a monopolistic market structure in that industry will not be a concern for policymakers since the monopolist will be forced to behave like a perfect competitor.

Research Areas

There are at least two important research issues here. First, the study done by Mercado (1987) must be updated in view of recent changes in policy and new developments such as reduction in the tariffs on imported polyester products since said study was completed. Estimates on domestic resource cost is important to assess the comparative advantage of the industry.

Second, because of its forward linkages, the case study on man-made fiber should be expanded to include downstream industries, i.e., the entire textile industry and the garments industry, to determine the more pressing barriers and effects of the larger industry problems.

III GLASS MANUFACTURING

BACKGROUND[1]

Definition of the Industry

Glass is a hard, brittle substance, usually transparent, made by fusing silicates with soda or potash, lime and, sometimes, metallic oxides. There are generally two types of glass products, namely container glass and flat glass. Container glass is mainly used by the food, beverage and chemical sectors in the form of jars, bottles, bowls, injectibles, drinking glasses and pitchers. On the other hand, flat glass is commonly used in the construction, appliance, automotive and other industries. This study focuses on the flat glass subsector.

There are different types of flat glass, namely sheet glass, figured glass, plate glass, tempered glass and float glass. Each of these types is described below:

Sheet Glass

This is a transparent flat glass having a glossy, fire-finished surface. Depending on its thickness, it has a visible transmittance that ranges from 89 to 91 percent. It is available in the thickness range of 2.0 mm to 5.5 mm and in various sizes. In the construction industry, sheet glass is used extensively in window glazing, door panels, skylites and partitions for housing, commercial and institutional buildings. It is used as well in the manufacture of automotive safety glass, mirrors, picture frames, desk and table tops, glass display shelves, oven doors, aquariums and a host of other applications.

Figured Glass

This is a transparent flat glass with decorative patterns cast on one surface. The pattern designs permit varying degrees of translucency from almost clear to obscure. The primary functions of figured glass are associated with light diffusion and decoration. Its semi-transparent feature takes full advantage of daytime's natural light while providing privacy. Figured glass is available in three basic thicknesses (3.0, 5.0, and 5.5 mm) and in a selection of five patterns. As in sheet glass, it is used in glazing windows, such as casements and louvers. It is also used as partitions, light diffusers, decorative panels and shower stalls. In the appliance industry, it is used as refrigerator crispers.

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[1] This study partly draws on the studies done by EVSA Corporation, "Glass and Ceramics Flat Glass," Unpublished (1989) and PIDS-Tariff Research Team, "A Study of the Effects of the Import Liberalization of the Flat Glass Industry," Unpublished (1985).

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Plate Glass

This is produced out of rough blanks cast from the figured glass furnace. The rough blanks undergo further processing through mechanical grinding and polishing, which impart a polished, completely plane and distortion free surface to the glass. It is available clear or tinted and in thicknesses of 6.0 mm, 10.0 mm and 12.0 mm. The maximum size of plate glass is 1.829 m x 2.438 m. As a construction material, plate glass is used in window glazing, particularly in curtain wall applications. It is also used in sliding windows and door panels. Other uses of plate glass are display stands, high quality mirrors, tempered automotive glass, table tops and others.

Tempered Glass

This is manufactured from annealed flat glass by a special heat treatment or tempering process which imparts greatly increased mechanical strength and thermal shock resistance. It cannot be cut or polished after such treatment. It is recommended in applications where safety is a major consideration, where an essentially high mechanical strength is required or where temperatures up to 288 degrees centigrade (550 degrees fahrenheit) are encountered. Its greater strength will support about four times the weight supported by ordinary glass of the same thickness. It will also bend about four times as far without breaking. However, it is breakable and, when broken, disintegrates into numerous small fragments of cubical or granular shapes but without the jagged edges or shards that occur when ordinary glass breaks. This pattern of breakage reduces the chance of serious personal injury. It is a product for providing safety.

In the construction industry, it is used for sliding patio doors, tub enclosures and other applications where safe break characteristics are required to protect people in case of impact. It is also used for automotive windows, spandrels and oven doors. It is available either flat or curved depending on the requirements of the end-use application and is manufactured to conform to applicable provisions of acceptable standards.

Float Glass

This has virtually plane and parallel surfaces formed by floating in a continuous ribbon of glass in the surface of a bath of molten metal in a controlled atmosphere. Since the surface of float glass is fire-finished, it produces a more sparkling lustre than polished plate glass when seen by a trained observer.

The Glass Making Process

The major raw materials that feed the glass industry are minerals found abundantly in the Philippines. These are silica, sand, dolomite, feldspar and limestone. The imported ingredients are soda ash and salt cake, comprising about 10 percent of the total raw materials.

There are four basic stages in the manufacture of glass: melting, forming, annealing and finishing. The raw materials are first mixed in a "batch" house. The "batch" is then fed into one end of a refractory tank furnace where it is melted at temperature exceeding 2,700 degrees fahrenheit. The molten glass can then be shaped into sheets.

There are three forming processes. The first is done by drawing sheet vertically or horizontally from molten glass. The second is done by casting or rolling molten glass leaving the furnace a "sill block." The third, which is a relatively new technology, is through the so-called float glass process. With this technology, flat glass is made by literally floating the molten glass onto a tank of molten tin so that the perfectly level surface of the tin induced by gravity is taken up the molten glass.

The annealing process follows after the forming process. This is done by holding the glass above a certain critical temperature to reduce internal strain by plastic flow to less than a predetermined maximum and then cooling the glass slowly to room temperature to hold the strain below this maximum. The finishing part includes cleaning, grinding, polishing, cutting, sandblasting, enameling, grading and packaging.

Special types of glass need further processing. For instance, the tempered glass used for automobile windshields and windows, as well as French floors and large windows, is made by reheating glass sheets and then air-quenching them. The process toughens the glass, making it several times more durable than ordinary glass sheets. Figured glass used in decorative windows and doors is made by passing sheet glass through patterned rollers. The pattern is thus embossed on the glass sheets giving it a characteristic design.

Emergence of the Flat Glass Industry

Before 1960, the Philippines imported all its sheet glass requirements from Belgium, France, Japan and the U.S. at a cost of US$1.6 million per year. With the country's foreign exchange problems in the second half of the 1950s, a group of 23 enterprising industrialists headed by Harry S. Stonehill, an American citizen, explored and assessed the possibility of establishing a local sheet glass manufacturing plant. Stonehill conducted personal negotiations for credit lines from the US Export-Import Bank for the purchase of machinery. Assistance was also extended by the Central Bank, the National Economic Council and the Industrial Business Management Corporation (of which Stonehill was the president). In March 1958, the beginnings of the local flat glass industry was notched with Stonehill's announcement of the ground breaking of the country's sole flat glass manufacturer, the Republic Glass Corporation (RGC), in Pasig.

RGC was organized in 1956 with the goal of saving foreign exchange through import substitution. However, it was only in 1960 that it began to supply the local market with flat glass. The first window plant was installed in Pinagbuhatan, Pasig in 1960, and with this the company's first furnace went on stream.

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With the unprecedented growth in market demand, the company started expanding its product lines to put the company's primary product, which is raw glass, into more uses. It diversified in 1965 to rolled-figured glass. Two years later, a polished plate glass plant was added to the company's facilities. The company entered the tempered glass field in 1974 to supply the automotive industry with high quality safety glass for trucks and buses. In 1976, it included tinted plate glass in its product line. The company manufactures almost all types of flat glass products except specialty glass and float glass.

The company entered the export market in 1973 when it began exporting to the US, Canada, Australia, Hong Kong, Singapore, Indonesia, Sri Lanka and the Dominican Republic.

Technological Innovations

As mentioned above, there are four stages of glass making production. It is in the second stage where there is a choice of technology. RGC uses the drawing technology for the manufacture of sheet glass and the rolling technology for its plate and figured glass. With the joint venture with Asahi Glass Co., RGC went into a float glass project. It adopted the latest innovations and techniques in glass making. The less energy intensive process, high productivity and improved yields enhance the competitiveness of the company's product in the domestic and world market. The technology necessary for the design, construction, operation and maintenance of the float glass line was provided by Asahi Glass Co.

Economic Contribution

Employment in the flat glass industry is very small - not more than one thousand (Table 3.1). This is because the industry is a capital-intensive one. Its contribution to the total value-added of the glass industry is, however, quite significant (Table 3.2).

Table 3.1
Employment Generation in the Manufacture of Flat Glass Industry Sub-Sector

YEAR	Total Employment in the Manufacture of Glass & Glass Products	Employment in the Manufacture of Flat Glass	Percent Employment to Total Employment
1981	9,492	1,033	10.88
1982	n.a.	972	n.a.
1983	7,247	982	13.55
1984	5,381	875	16.26
1985	5,063	647	12.78
1986	4,635	706	15.23
1987	5,120	983	19.20

Note: n.a. -- not available

Sources: Census of Establishments (1972, 1975, 1978, 1983), National Statistics Office (NSO).
Annual Survey of Establishments (1983, 1984, 1985, 1987), NSO.

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Table 3.2
Value Added in the Manufacture of Flat Glass
Industry Sub-Sector

YEAR	Total Value Added in the Manufacture of Glass & Glass Products	Value Added in the Manufacture of Flat Glass	Percent Value Added to Total Value Added
1972	95,586,000	18,572,000	19.43 %
1975	91,185,000	17,105,000	18.76 %
1978	791,600,000	398,360,000	50.32 %
1983	375,912,000	122,531,000	32.60 %
1984	735,637,000	n.a.	n.a.
1985	518,701,000	n.a.	n.a.
1986	845,923,000	n.a.	n.a.
1987	1,080,478,000	n.a.	n.a.

Note: n.a. -- not available

Sources: Census of Establishments (1972, 1975, 1978, 1983), NSO.
Annual Survey of Establishments (1983, 1984, 1985, 1987), NSO.

The flat glass industry has strong forward and backward linkages with domestic industries. About 90 percent of its raw materials are sourced from the domestic market. The 1983 input-output table reveals that 14 percent of the total input of the glass industry (including flat glass, container glass and miscellaneous glass and glass products) comes from other non-metallic mining and quarrying.[2] Approximately 90 percent of flat glass sales cater to the local construction, automotive, appliance, and other industries, with the bulk of sales going to the construction industry. The 1983 input-output table shows that 56.6 percent of total output of the glass industry went to the construction industry.

INDUSTRY PROFILE

Industry Structure

The glass and glass products industry is a highly concentrated industry. The top three firms contributed 84 percent of the total value added of the industry. In the flat glass sub-sector, there is only one domestic manufacturer, i.e., the RGC. There are, however, direct importers who distribute imported flat glass products to downstream firms. Still, RGC has been dominating the market with about 90 percent market share. The structure of the flat glass sector is depicted below.

[2] Note that in the input-output table, the flat glass sub-sector could not be segregated from the glass industry.

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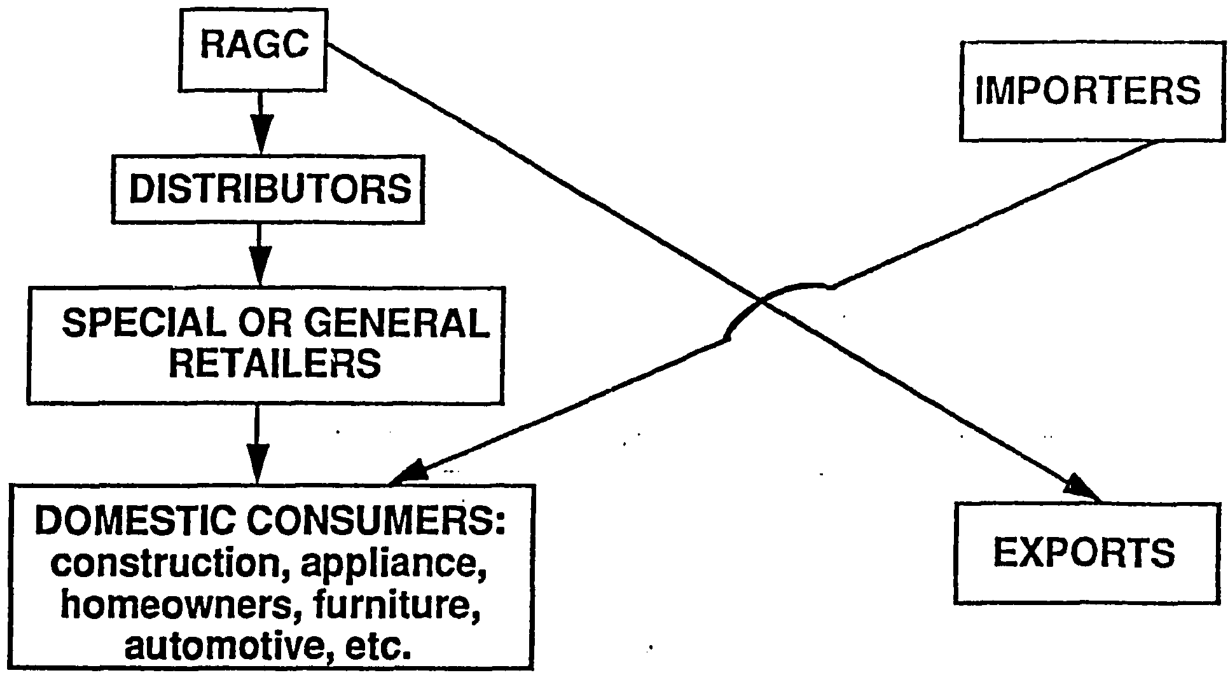
Figure 3.1: Structure of Flat Glass Sector



RGC has seven main distributors in the country and nine depot facilities to facilitate the distribution. The distributors do not compete among themselves since they are located in separate geographical areas of the country.

Ownership Structure

RGC was a 99.3 percent Filipino-owned public company. However, out of more than 800 investors, two are dominant, namely Gervel Incorporated (46.67 percent) and Jaka Investment Corporation (32.96 percent).

In 1989, RGC entered into a joint venture with Asahi Glass Company, a leading flat glass manufacturer of Japan. This project involved the construction and installation of a 400 Metric Ton (MT)/day float glass manufacturing facility and a mirroring line to be installed at the existing plant site of RGC.

The joint venture project featured an off-take arrangement with Asahi Glass Co. for the export of some production output during the early years of the plant, assuring the plant's operations at maximum capacity. The scope of the undertaking involved an investment of ₱ 3.1 billion. The project was financed under a 60:40 debt-to-equity structure. Debt financing, which was guaranteed by the Asahi Glass Co., was obtained from a foreign financial institution for the foreign currency requirement and a syndicate of local lending institutions for the peso costs. RGC takes 51 percent equity interest while the extent of Asahi Glass Co.'s participation is 49 percent. This joint venture is registered with the Securities and Exchange Commission under the name Republic Asahi Glass Corporation (RAGC). RAGC formally started operations in January, 1991, with the transfer of substantially all of the glass-making assets of RGC.

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Market Demand and Supply

As indicated above, the construction industry is the biggest user of flat glass products. Demand for flat glass products is therefore a derived demand. Since glass is needed towards the finishing touches of any construction activity, demand for glass products lags behind construction activity.

Table 3.3 shows the historical demand for flat glass, which is defined as the sum of the domestic sales of RAGC and imports. Demand plunged precipitously in 1984 as the economy went through a crisis. It picked up rapidly in 1987, and in 1990 it is estimated to have reached 63,255 MT.

Table 3.3
Demand for Flat Glass
(In Metric Tons)

YEAR	TOTAL	DOMESTIC SALES	IMPORTS	RATIO
1980	35,753	28,011	7,742	78:22
1981	33,141	26,866	7,362	81:19
1982	35,170	28,895	6,275	82:18
1983	42,347	37,280	5,067	88:12
1984	34,011	32,155	1,856	94:06
1985	25,576	22,072	3,504	86:14
1986	25,591	21,972	3,619	86:14
1987	41,404	34,090	7,314	82:18
1988	44,747	35,000	9,927	78:22
1989	56,000	38,464	17,537	69:31
1990	63,255	36,616	26,639	58:42

Source: Republic Glass Corporation

The data for domestic sales in 1989 and 1990 seem to be misleading. What actually happened was that RAGC imported flat glass from Asahi Glass Co. as part of the company's strategy to create market awareness for the float glass product in preparation for its new project, the manufacture of flat glass using the Asahi Glass Co.'s process. Furthermore, several of RAGC's furnaces closed down in February and April 1990 and domestic demand for flat glass had to be met by imports as commercial operations of the float glass plant only commenced last January 1991.

As can be seen from Table 3.4, most of the sudden rise in imports of flat glass in 1989 and 1990 could be attributed to the more than 100 percent increase in the importation of float glass. Another notable factor that can be observed from the same table is that the share of imported glass mirrors in total imports of flat glass is relatively large. The bulk of these were actually float glass but were passed on as glass mirrors because of lower tariff duties if they come from ASEAN countries because of preferential trade arrangement. Most of the imported glass mirrors came from Singapore, which obviously also came from other countries.

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Table 3.4
Philippine Imports of Flat Glass by Types, 1980-1990
Quantity in Net Kilograms, Value in CIF Dollars

Year	1980 Quantity	1980 $ CIF	1981 Quantity	1981 $ CIF	1982 Quantity	1982 $ CIF	1983 Quantity	1983 $ CIF	1984 Quantity	1984 $ CIF	1985 Quantity	1985 $ CIF
664.31-00 Unworked Sheet Glass	403,788	350,735	18	342	6,900	2,273	12,864	19,833	0	0	0	0
664.32-00 Sheet Glass of Laminating Quality	85	1,117	176,639	76,193	100	597	14,425	26,800	0	0	0	0
664.41-00 Plate Glass	887,027	227,761	887,808	476,091	267,055	117,755	63,136	63,226	82,116	82,242	1,330	4,120
664.42-00 Float Glass	5,999,908	2,884,470	5,639,090	3,339,505	5,449,704	3,785,595	4,231,960	2,004,772	1,583,870	777,930	2,311,816	932,777
664.50-00 Cast of Rolled Glass	24,560	13,010	154,619	71,821	65,901	32,168	33,420	15,670	6,000	5,906	44,054	35,671
664.60 Press/Acided Glass Multi-Cellular Glass	34,812	48,076	57,160	91,805	53,523	34,509	24,241	11,732	1,528	32,771	17,850	17,969
664.71-00 Flat Laminated Safety Glass	171,234	168,644	79,900	209,512	31,805	92,009	130,715	326,837	5,015	24,076	13,789	34,953
664.72-00 Laminated & Hardened Safety Glass	161,288	436,060	181,188	331,606	209,501	218,309	336,353	519,613	130,220	67,059	251,279	120,620
664.80 Glass Mirrors	59,629	132,562	185,884	315,176	190,696	262,458	219,804	243,333	47,426	93,943	864,146	465,972
TOTAL IMPORTS	7,742,331	4,262,435	7,362,306	4,912,051	6,275,185	4,545,673	5,066,918	3,231,816	1,856,175	1,084,109	3,504,264	1,612,082

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Table 3.4 (continued)

Year	1986	1987	1988	1989	1990				
	Quantity	$ CIF	Quantity	$ CIF	Quantity	$ CIF	Quantity	$ CIF	Quantity	$ CIF
664.31-00 Unworked Sheet Glass	0	0	0	0	0	0	0	0	0	0
664.32-00 Sheet Glass of Laminating Quality	22,500	29,454	17,000	28,150	0	0	167,029	72,596	51,962	42,781
664.41-00 Plate Glass	8,035	6,447	0	0	0	0	0	0	75,662	59,921
664.42-00 Float Glass	2,144,657	812,251	4,676,601	1,984,014	6,818,766	3,421,678	13,446,609	7,921,146	23,823,143	14,942,259
664.50-00 Cast of Rolled Glass	81,305	103,970	365,533	264,636	75,158	183,955	951,169	372,056	185,670	90,313
664.60 Press/Acided Glass Multi-Cellular Glass	30,505	37,356	109,816	228,425	210,942	394,057	193,245	142,093	168,840	97,282
664.71-00 Flat Laminated Safety Glass	5,966	14,384	4,364	29,835	127,444	238,949	122,683	135,646	18,498	42,584
664.72-00 Laminated & Hardened Safety Glass	268,648	178,437	88,888	43,768	269,712	645,519	481,682	867,679	373,233	528,753
664.80 Glass Mirrors	1,057,557	519,910	2,051,365	865,060	2,425,286	1,250,022	2,174,904	1,495,434	1,942,359	1,336,775
TOTAL IMPORTS	3,619,173	1,702,209	7,313,576	3,434,888	9,927,308	6,134,180	17,536,852	11,006,650	26,639,367	17,141,668

Source: Foreign Trade Statistics of the Philippines (1980-1990). National Statistics Office.

As already mentioned above, RAGC is the country's sole domestic manufacturer. It entered the 1980s with a rated capacity of 42,000 MT. This increased to 71,000 MT in 1984, but declined to 63,300 MT during the period 1985-1989. With the commercial operation of its newly installed float glass plant, RAGC's rated capacity went up to 149,000 MT. This more than meets the entire domestic requirements for flat glass for the next ten years.

The capacity utilization of RAGC has been relatively high except in the crisis years (Table 3.5). In view of the large production capacity of RAGC relative to domestic demand, Asahi Glass Co. will undertake the importation all excess production in the initial years, which is expected to decline over the years as domestic demand expands. For instance, RAGC expects to export 100,000 metric tons in 1991, which will decline to 60,000 metric tons by 1998. The ratio of locally produced and imported flat glass will remain at 90:10 from 1991 onwards.

Table 3.5
Capacity Utilization of Republic Glass Corporation

Year	Rated Capacity (in Metric Tons)	Production (in Metric Tons)	Capacity Utilization (in Percent)
1981	42,000	40,900	97
1982	42,000	35,000	85
1983	42,000	33,000	80
1984	71,000	39,915	54
1985	63,300	21,390	34
1986	63,300	31,462	50
1987	63,300	47,852	76
1988	63,300	56,271	89
1989	63,300	58,490	92
1990	63,300	42,430	67
1991	149,000	149,000	100

Source of Data: RGC Annual Reports.

Competition

Flat glass is a capital- and skills-intensive industry. The RGC plant was built in 1960 at an initial cost of ₱ 10 million and had an initial capacity of 20,000 metric tons a year. As of December 1990, RAGC's fixed assets amounted to ₱ 2.4 billion. The float glass project of RAGC alone requires ₱ 3.1 billion investment. Being the only flat glass manufacturer in the country, RGC had to conduct its own training programs since glass manufacturing requires relatively high skills. In view of this, and the fact that currently RAGC can supply the domestic requirements for at least the next ten years, it would be very difficult for a new entrant to enter the market. The relatively small domestic demand for flat glass will not allow the new entrant to exploit economies of scale unless it arranges a tie-up with foreign firms with the same arrangement as that of RGC and Asahi Glass Co.

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The only potentially strong competitor of RAGC is imports. However, RGC had been protected from imports through quantitative restriction and high tariff walls. It is one of the industries that will receive the highest tariff rate of 50 percent under EO 470, although this would decline to 30 percent by 1995.

The implication of this on the pricing system adopted by RGC is clear. It has been adopting a two-tiered pricing system - a high price for domestic market where it wields some monopoly power and low price for the world market where it does not have a monopoly power. As shown in Table 3.6, domestic prices of its sheet glass and figured glass had been set much higher than export prices of the same products.

Table 3.6
Comparison of Domestic and Export Price
of Sheet Glass and Figured Glass
(In Pesos per Metric Ton)

	Sheet Glass		Figures Glass	
Year	Domestic	Export	Domestic	Export
1981	5,663	3,021	4,256	2,982
1982	5,782	3,378	4,466	3,138
1983	6,049	4,164	4,386	3,853
1984	9,323	6,178	6,663	4,909
1985	12,345	5,470	8,690	5,058
1986	12,395	5,686	9,349	4,932
1987	12,419	6,024	9,534	4,585

Source: Board of Investments (BOI).

Performance of RGC

RGC has been a very profitable firm. It has never experienced a loss since it started operating even during the 1983-1985 economic crisis (Table 3.7). Its net income in 1989 was ₱153 million. The return on equity has been very high except in the first half of 1980s. The period 1987 to 1989 was particularly favorable to RGC as rate of return on equity went up to more than 20 percent. Note that even during the 1983-85 economic crisis when its production went down, its net sales went up, which could only happen if prices were adjusted upwards. This again suggests the extent of monopoly power wielded by RGC in the domestic market.

Table 3.7
Republic Glass Corporation
Financial Highlights
(in P '000)

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990*
NET SALES	58,472	67,521	100,196	115,382	136,023	154,045	164,146	178,201	185,517	229,398	291,376	269,631	281,611	447,246	603.522	778,955	911,207
NET INCOME	7,100	6,078	12,367	14,924	15,746	20,002	7,132	7,673	8,198	16,940	8,327	2,078	19,049	35,406	68,085	153,127	57,957
TOTAL ASSETS	95,333	119,668	140,838	153,395	144,059	248,092	279,790	363,464	383,409	435,183	467,813	384,905	370,593	352,510	421,089	1,040,861	3,193,215
TOTAL LIABILITIES	37,713	62,537	79,969	89,071	81,197	80,553	118,898	200,468	217,059	257,075	317,668	232,676	207,684	190,867	221,687	301,964	1,876,595
TOTAL EQUITY	57,620	57,131	60,869	64,324	62,862	167,539	160,892	162,996	166,350	178,108	150,145	152,229	162,909	161,643	199,402	738,897	1,316,520
FIXED ASSETS	n.a.	n.a.	n.a.	61,358	72,030	171,183	150,652	188,942	227,627	260,075	237,570	215,301		176,056	125,000	437,315	2,445,642
RATIO OF FIXED ASSETS TO TOTAL ASSETS	n.a.	n.a.	n.a.	0.40	0.50	0.69	0.54	0.52	0.59	0.60	0.51	0.56		0.50	0.30	0.42	0.77
CURRENT ASSETS/CURRENT LIABILITIES	n.a.	1.71	1.78	1.84	2.02	1.60	1.18	1.39	1.22	1.17	1.01	1.03	1.19	1.61	1.55	1.40	4.16
INCOME/ASSETS (%)	7.45	5.08	8.78	9.73	10.93	8.06	2.55	2.11	2.14	3.89	1.78	0.54	5.14	10.04	16.17	14.71	1.82
INCOME/SALES (%)	12.14	9.00	12.34	12.93	11.58	12.98	4.34	4.31	4.42	7.38	2.86	0.77	6.76	7.92	11.28	19.66	6.36
INCOME/EQUITY (%)	12.32	10.64	20.32	23.20	25.05	11.94	4.43	4.71	4.93	9.51	5.55	1.37	11.69	21.90	34.14	20.72	4.40
DEBT-EQUITY RATIO	0.65	1.09	1.31	1.38	1.29	0.48	0.74	1.23	1.30	1.44	2.12	1.53	1.27	1.18	1.11	0.41	1.43
TOT. LIABILITIES/ TOT. ASSETS	0.40	0.52	0.57	0.58	0.56	0.32	0.42	0.55	0.57	0.59	0.68	0.60	0.56	0.54	0.53	0.29	0.59
EQUITY/ASSETS	0.60	0.48	0.43	0.42	0.44	0.68	0.58	0.45	0.43	0.41	0.32	0.40	0.44	0.46	0.47	0.71	0.41

* - 1990 marked the start of the joint venture company's operation under the name Republic-Asahi Glass Corporation.

Source: Business Day's Top 1000 Corporations in the Phil.

The first year of RAGC's operation had also shown favorable results as borne out by increased sales and positive returns. Total assets of the company increased threefold as a result of the investment in the float glass project.

Policy and Regulatory Framework

There is no explicit government policy to have only one domestic manufacturer in the flat glass industry. However, there were some measures put in place that effectively protected and conferred advantages to the incumbent domestic manufacturer. RGC registered with the BOI as a preferred pioneer enterprise for polished plate glass under R.A. 5186 (Investment Incentives Act) and as an export producer of window and figured glass under the Export Incentives Act (R.A. 6135). Under R.A. 6135, the company was entitled to tax and non-tax incentives such as special tax credit on raw materials and supplies of exported finished goods, accelerated depreciation and tax exemption on imported capital equipment.

In 1978, a Memorandum to Authorized Agent Banks (MAAB) was issued by the Central Bank stipulating that all import applications under any mode of payment for sheet glass of laminating quality, suitable for the manufacture of safety glass shall not be given due course unless accompanied by a certification from the Department of Industry. This effectively put in place import restriction on most flat glass products.

In 1981, the government launched a tariff reform program. The tariff rates on flat glass were supposed to be gradually lowered from 70 percent in 1983 to 50 percent in 1985. However, during the 1983 balance of payments crisis, the Central Bank issued a MAAB that effectively reimposed import restriction on flat glass products.

The Aquino government resumed the import liberalization program in 1987. Under the said program, flat glass products were supposed to be liberalized in January 1987. However, RGC asked for a postponement of its effectivity since it was in the process of negotiating with Asahi Glass Co. for the manufacture of flat glass using the float glass process. In view of this, the government reset the liberalization of flat glass products to January 1988.

Under EO 470, the rate of duty for flat glass products has been scheduled to gradually decline from 50 percent in 1991 to 30 percent in July 1995. On the other hand, raw materials used in the production of flat glass are freely importable at lower tariff rates of about 10 percent.

RAGC registered with the BOI in 1988 under the Omnibus Investment Code of 1987 as a pioneer industry producing for the domestic market. Under the Code, BOI-registered firms are given tax holidays.

The main conclusion that can be drawn from the analysis above is that there is presently a formidable entry barrier in the flat glass industry, and that it is structural in nature. This derives from RAGC's recently expanded production capacity, modernized production process, and special financial, technical and marketing arrangement with Asahi Glass Co. of Japan. The former RGC had been operating efficiently.

Nonetheless, it could be argued that the protection and incentives given to RGC by the government had allowed it to enjoy extra benefits, which presented a barrier to other entrants. RGC , later RAGC, built its dominant position behind this shelter, that EO 470 had in fact maintained.

GENERAL ASSESSMENT

Emergence of Entry Barriers

The flat glass industry started out as a typical import-substituting industry whose initiative came from the private sector but was later on promoted by the government through import restriction and high tariff walls. The protection seems to have been maintained for an unnecessarily too long a period. In fact, as far back as the 1970s, RGC had already been exporting, which means that it had been able to exploit economies of scale and could compete in the world markets. This is confirmed by its relatively high capacity utilization, except during the crisis period in the mid-1980s. The pricing system of RGC reflects this, i.e., its export price has been much lower than its domestic price for the same product lines. One implication here is that it could easily align its domestic price with world price if new entrants would come in. Potential entrants must have perceived this, and given the high capital requirement and the long gestation period for the investment, they may not be able to survive the competition.

Aside from the relatively high capital requirement that the new entrant must hurdle, the joint venture between RGC and Asahi Glass Co. gives a new twist to competition. At present, the production capacity of RAGC is quite large relative to domestic demand, but it will be able to operate at full capacity at all times and thereby realize scale economies since Asahi Glass Co. guaranteed that it will be responsible for exporting any excess supply. Thus, any entrant will have difficulty entering the market unless it gets a similar deal from foreign glass manufacturer. Even imports are having difficulty competing with RAGC since aside from the 5 percent import levy, import prices are 20 percent higher than those of RAGC's products. In fact, imports of float glass for the period January-March 1991 already dropped to 152 metric tons from 4,375 metric tons for the same period last year.

Moreover, RAGC seems to have found a way of dealing with competition from imports. When the flat glass industry was liberalized, RAGC went into importation of flat glass and eventually became the largest importer. It knows import prices very well, and this deters other importers from undercutting prices in the market. In fact, the reverse seems to hold true. In 1990, for instance, RAGC had to price its imports at least 5 percent lower than the landed cost in order to match import prices of traders. There seems to be reasonable ground to reduce further tariff rates on imported flat glass below those prescribed by E.O. 470. In fact, RAGC does not need anymore tariff protection given the scale economies it is now operating.

That the domestic flat glass industry, which is controlled by one firm, was given high protection and incentives is hardly surprising at all. The major stockholders of the firm were Gervel, which is owned by Geronimo Velasco who was one of the technocrats of President Marcos, and Jaka Investments, which is owned by Juan Ponce Enrile, the Secretary of Defense of the Marcos' government until he broke away from him in 1986.

Impact on the Economy

The various types of glass products mentioned above are important intermediate inputs in the construction industries. They have substitute products as construction materials; to wit: metals, wood, plywood, cement and ceramics. The demand for glass as a construction material seems to have increased over the years. The ultimate domestic users of glass products, namely the households and real estate owners, must have been penalized by the unnecessarily high prices of glass products. Users of glass products in other countries where RGC exported its products are better off because they are charged the world prices of those products that are much less than the domestic prices.

With the liberalization of flat glass, there would now be two types of competitors to the incumbent. One is a potential manufacturer. However, it is going to face a formidable entry barrier now being set up by RAGC. A new entrant is therefore highly unlikely in the near future. The other type of competitors are the importers of flat glass. They will also have difficulty competing with RAGC in the domestic market especially since imports of finished products are slapped a 30 percent tariff. Nonetheless, the liberalization of importation of flat glass has already reduced the incentive of RAGC to extract monopoly profits.

The protection and incentives provided by the government to RGC in the past allowed it to extract monopoly profits. The protection is redundant because it can operate efficiently. The recent import liberalization of the glass industry forces RAGC to behave competitively.

Policy Directions

The policy direction is rather obvious. Government authorities should reconsider the high tariff structure on flat glass and open the sector to the rigors of international competition. Protection is not needed anyway since RAGC has demonstrated that it can compete in the export markets and that it can handle threats of imports in its domestic turf.

The benefits of such liberalization move are twofold: enhanced consumer welfare and increased export revenues. To compete against imports, RAGC will have to lower domestic prices, thereby benefiting end-users. At the same time, RAGC will have to penetrate the export markets, bringing in additional dollar earnings. In summary, if the government has to intervene, it should be to infuse competitiveness, not to continue insulating the incumbent from competition.

There are other policy areas that could improve the efficiency of the flat glass industry. Another area has to do with reducing its high distribution cost. Since the plant of the sole manufacturer is located in Metro Manila, glass flat products are distributed throughout the country by ships and barges. High freight rates for domestic markets and slow turnaround have raised its distribution cost. The best way to address this problem is to deregulate the shipping industry. Another has to do with reducing the cost of power to the sole manufacturer. Presently, the cost of power constitutes about 35 percent of the total production cost. This could be cut down by half if the firm is allowed to source directly its power requirements from NAPOCOR instead of MERALCO.

Research Areas

One of the complaints of the incumbent is the rampant misdeclaration of imports with the import liberalization program and the ASEAN margin of preference. This should be empirically verified so that appropriate measures could be installed.

Since there is a great potential for the flat glass industry to become an export-oriented industry, trade policy of countries with potential markets for flat glass products should be studied. Some countries impose import quota while others set up non-tariff barriers, such as licensing and strict standards, to make imports difficult. This should be valuable information to policymakers and the incumbent firm.

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IV CEMENT MANUFACTURING

BACKGROUND

Definition of the Industry

This study covers the firms engaged in the manufacture of cement. The cement industry currently consists of 18 plants operated by nine owners/operators with a combined annual capacity of 194.9 million 40-kg bags (7.8 million tons) as of the end of 1991.

Cement is a high-grade bonding agent used as a construction raw material to make concrete. It is a homogeneous commodity composed of limestone, cement rock, clay, and iron ore. These ingredients are processed into clinker, which is then ground and mixed with gypsum to make the final product. Compared with other bonding agents, such as hydraulic limes and Roman limes, cement has superior hardening properties but requires a higher burning temperature during manufacture.

Product Types

Three types of cement are manufactured in the Philippines: Portland (or Type 1), Pozzolan Type P and Pozzolan Type 1-P. Portland is the most popular, accounting for 58 percent of total production in 1990, and has been manufactured in the country since the industry's beginnings. The other two types, which are Portland cement mixed in with Pozzolanic materials, were introduced in the late 1980s in response to cement shortages.

Pozzolan Type P developed its compressive strength later than Portland cement, but over time surpasses the latter in strength. Pozzolan Type 1-P, the newest form, has a lower Pozzolan content than Type P, and similar compressive strength and setting time to Portland cement.

Pozzolan-type cement is cheaper than Portland because of its lower energy requirements during manufacture, and greater yield per clinker ton. It has greater resistance to crack formation and saltwater corrosion than Portland cement. The producers claim that these qualities and the abundance of pozzolanic material in the Philippines make Pozzolan cement better suited to Philippine use. At present, 15 plants produce Pozzolan cement in addition to Portland cement.

There are also specialized cement forms although the market for them is not significant. One specialty type is white cement, so-called because it differs in color from ordinary gray cement. White cement costs more than its regular counterpart and is used mainly for aesthetic purposes.

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Model of Noncompetitive Behavior

As noted in the Main Report, cement manufacturing appears relatively less concentrated than the other sectors under review. The top three, and top four, firms in the industry produced, respectively, 39 percent and 48 percent of the industry's 1988 output. However, when considering ownership blocs, the dominant bloc and the three largest blocs respectively accounted for 46 percent and 75 percent of 1991 sales. The industry was primarily chosen for study as a model of noncompetitive behavior abetted by the government regulatory agency.

When the industry suffered huge losses during the period of chronic overcapacity in the early 1970s, the plants (many of whom had direct government participation in the form of guarantees, loans, and equity) sought regulations as a way to avoid cutthroat competition. Partly in response to this, and partly to protect its financial interests, the government established the Philippine Cement Industry Authority (PCIA) in 1973 to regulate the industry. Henceforth, until its abolition in 1987, the PCIA's approval was required to set up a new plant or expand an existing one. Among other powers, it also had the authority to export clinker or cement, establish sales quotas and distribution areas, advise the price control body on uniform prices, and make bulk purchases of raw materials for the industry.

From its inception the PCIA worked closely with the manufacturers through their trade association, currently known as the Philippine Cement Manufacturers Corporation (Philcemcor[1]). Because of Philcemcor's long history (it began in 1957 as the Cement Institute of the Philippines), its experience in monitoring the industry, and the presence of influential business leaders at its helm, it was inevitable that it would eclipse the PCIA in some of the latter's roles.

The PCIA delegated some of its functions to Philcemcor. One such function was the setting of production quotas. Philcemcor today, as then, continues to hold regular monthly meetings to set production quotas. It has also arranged for the geographical apportionment of the markets that restricted Luzon plants to selling in the Luzon area, and Visayas/Mindanao plants, to their area. This informal arrangement is set aside during shortages.

Philcemcor officials candidly admit to the collusionary nature of the institution's actions. However, government regulators (the PCIA, and after its abolition, the Board of Investments) have tolerated these actions in the interest of maintaining the viability of existing firms.

The PCIA was abolished in 1987, and some of its powers were transferred to the Department of Trade and Industry (DTI) and the Board of Investments (BOI). Philcemcor remains primarily responsible for the setting and monitoring of product quality standards.

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[1] Philcemcor's operations are financed principally by a monthly levy on the cement firms, at present amounting to ₱0.02 per cement bag of monthly rated capacity.

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INDUSTRY PROFILE

Historical Overview of the Industry

The first Philippine cement plant, the privately owned Rizal Cement, was established in 1914. The first half of the century saw just two other additions: the government-owned Cebu Portland Cement Company in 1924, followed by Philippine Portland Cement Company (PANAY) in 1949. (See Table 4.1.)

Table 4.1
History of Plant Entry/Exit/Closings

Firm	Entry	Exit	Closings
1. Rizal	1914		1928-30, 1940-45
2. CEPOC/Apo	1924		
3. PANAY	1949	1970	
4. Bacnotan	1954		
5. Republic	1955		
6. Universal	1960		1970s
7. Filipinas/FR	1964		1970s
8. Mindanao	1965		
9. Marinduque/Island/Solid	1967		1970s
10. Pacific	1968		
11. Hi/Atlas	1968		
12. Midland/Titan	1968		1970s
13. Luzon/Central	1969		
14. Northern	1970		
15. Fortune	1970		
16. Iligan	1971		
17. Alsons/Floro	1972		
18. Continental	1973		
19. Davao Union	1983		

Source: Philcemcor

The sector experienced rapid expansion in the 1950s and 1960s as postwar infrastructure programs led to a steady increase in consumption. The resulting high profitability in the industry, coupled with government loans and guarantees provided through the Development Bank of the Philippines (DBP), attracted new entrants. Albarracin (1991) notes that "almost anybody with political influence could build a cement plant without equity investment by simply having the Development Bank of the Philippines guarantee the loans." The government stake in the sector exceeded one billion pesos in loans and guarantees.

By 1970, there were 19 cement plants, and almost the same number of players, with a combined annual production capacity of 187.5 million bags. Consumption, however, slumped during the early 1970s. Capacity utilization peaked at 82 percent in 1969, dipped to below 50 percent in 1971, and remained low during the succeeding years. Most firms in the industry suffered losses during this period and had to restructure their loans to avoid default.

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Desperate over their financial condition, industry players pressed for regulation to avoid cutthroat competition. The government, as the sector's largest customer and big stakeholder, moved to protect its interests. It established the PCIA in 1973, granting it powers, among others, to regulate the entry of new plants and expansions, recommend price levels, allocate production quotas, and control cement exports. At the same time, the existing trade industry was incorporated into what is now known as Philcemcor to assist the PCIA in carrying out its mandate.

Price controls and production quotas somewhat stabilized the industry's financial condition in the 1970s. The industry increased utilization by exporting some of its production even though world prices were lower than domestic prices at the time. This was made possible by the establishment of a subsidy pool (known as the "export kitty") funded by a levy on producers of 50 centavos per bag produced. Solely initiated and administered by Philcemcor, the subsidy reimbursed the six exporting plants[2] for the price difference. This subsidy pool came into play again -- but in a different role -- when shortages in the late 1980s necessitated imports. This time, because world prices were higher than domestic ones, the subsidy reimbursed the losses of manufacturers who imported cement.

Partly due to these regulations and partly to the collaborative relationship between PCIA and Philcemcor, noncompetitive behavior was fostered. This discouraged new entrants. From 1970 onwards, only one new plant was set up (namely, Davao Union in 1983, owned and operated by Phinma, an incumbent) even as six plants closed down[3]. Consolidations beginning in 1975 also reduced the number of players from 17 to nine.

The economic crisis in the early 1980s adversely affected the sector. Again, a number of cement firms failed to meet their obligations to the DBP. This time the government bailed them out by having DBP convert its loans to an equity stake. Efforts of the government to privatize led to further consolidation. Presently, there are nine players in the sector, of which three are major ones. One dominant player, Phinma, controls six cement plants accounting for 42 percent of total industry capacity.

Economic Contribution

The cement industry's share in the economy, at 1.4 percent of manufacturing gross value added (GVA) in 1988, is rather small. However, the direct link of cement with other industries such as construction makes it a critical sector in the economy. Moreover, it is generally recognized that cement consumption is an indicator of industrial activity.

Employment in the industry has dropped since 1981, from 9,744 in 18 firms that year to 5,893 in 17 firms as of 1988. Over this time labor productivity has increased from 10,253 bags of cement per employee in 1981 to 22,709 bags in 1988.

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[2] The exporting plants were Davao Union, Bacnotan, Iligan, Northern, Floro, and Republic, chosen for their proximity to ports.

[3] The plants that closed down were PANAY, Universal (now Lloyd Richfields), Filipinas (now FR), Marinduque/Island (now Solid), Floro (now Alsons), and Midland (now Titan). The latter five have been rehabilitated in recent years, with new names.

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Capital Intensity and Technological Level

The cement industry is highly capital-intensive. Capital costs, represented by interest and depreciation, account for up to 20 percent of manufacturing costs. Labor accounts for just four to five per cent of total costs. Capital costs per employee in the industry has been estimated at more than one million pesos (Albarracin, 1987). Investment cost of a medium-size new plant (16.5 million bags per year) has been estimated at $165 per ton per year (see Table 4.2).

Table 4.2
Investment Cost By Plant Size

	Daily Capacity (Metric Tons)	Cost Per Ton Per Year (US$)
Small-size Plant	500	240
	1,000	200
Medium-Size Plant	2,000	165
	3,000	150
Big-Size Plant	4,000	140

Source: Onoda, 1990

The industry is also energy-intensive, with energy costs ranging between 30 percent to 43 percent of manufacturing costs, depending on which type of manufacturing process is used (see Table 4.3). All but one of the plants currently operating in the country are over 18 years old. Established before the oil crises of the 1970s, these old plants use relatively energy-inefficient production processes that have been abandoned in other countries. Regulation, especially price controls, had the effect of keeping inefficient plants open and discouraging the introduction of efficient processes.

The processes currently in use in the Philippines are shown in Table 4.4. The Philippines is "practically the only one left" among its neighbors using the older wet process and lepol methods. In neighboring countries, 60 percent of the plants are precalciner plants and 40 percent suspension preheater plants, both of which are more fuel efficient.

The plants' 32 operating kilns can be classified into the wet, semi-dry, and dry processes, with the last being the most energy efficient of the three (see Table 4.5). Nineteen of the 32 kilns are of the less energy-efficient processes.

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Table 4.3
Estimated Manufacturing Costs per Ton of Portland Cement
In Pesos (% to total in parenthesis)

Cost Item	Luzon Dry	Luzon Semi-Dry	Luzon Wet	Visayas Wet	Mindanao Dry	Mindanao Wet
Raw materials	90 (8)	90 (8)	90 (8)	90 (8)	90 (8)	90 (8)
Fuel	270 (24)	320 (27)	390 (32)	260 (24)	220 (21)	330 (29)
Electricity	150 (13)	170 (14)	140 (11)	130 (12)	90 (9)	90 (7)
Gypsum	40 (4)	40 (3)	40 (3)	40 (4)	40 (4)	40 (4)
Consummables/repairs	80 (7)	80 (7)	80 (7)	80 (7)	80 (8)	80 (7)
Paper bag	130 (12)	130 (11)	130 (11)	130 (12)	150 (15)	150 (15)
Sub-total	760 (68)	830 (70)	870 (71)	730 (67)	670 (66)	770 (68)
Labor	50 (4)	50 (4)	50 (4)	50 (5)	50 (5)	50 (4)
Depreciation/Interest	210 (19)	210 (18)	210 (17)	210 (19)	210 (20)	210 (19)
General Expenses	100 (9)	100 (8)	100 (8)	100 (9)	100 (10)	100 (9)
TOTAL	1,120 (100)	1,190 (100)	1,230 (100)	1,090 (100)	1,030 (100)	1,120 (100)

Source: Onoda, 1990

The industry's response to increased petroleum costs was to substitute coal for bunker oil. Conversion was encouraged by government assistance in the form of concessionary credit, tax waivers on equipment imports, guarantees on coal prices (not to exceed 65% of crude oil prices), and the building of coal terminals. Today, all but Mindanao Cement have converted to dual lines[4].

[4] Because coal requires additional processing before it can be used, plants with dual lines switch to bunker oil when coal prices reach within 10 percent of bunker oil prices.

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Table 4.4
Energy Consumption by Process

Process	No. of Plants*	Typical Energy Consumption (kcal/kg cement)
Wet process	5	1500
Lepol	2	1100
Suspension preheater	8	970
Precalciner	2	840
		17

*Excludes Universal Cement, only recently reopened

Source: Albarracin, 1991

Table 4.5
Energy and Electricity Consumption by Process

Process	No. of Kilns	Total Capacity (tons/day)	Average Energy Consumption (kcal/kg clinker)	Average Electricity Consumption (kwh/ton cement)
Dry	13	12,330	1,100	150
Semi-dry	6	8,860	1,300	170
Wet	13	3,500	1,600	140
	32	24,690		

Source: Philcemcor

Industry Structure

Industry Players

There are nine players in the industry (see Table 4.6), of which three are big ownership blocs: the Philippine Investment Management Association (Phinma), the Zobel-Araneta group, and the Alcantara group which took over government interests in the Floro Cement plant.

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Table 4.6
Industry Groupings and Capacity

	Rated Capacity (In Thousand Bags)	Share (%)
TOTAL CAPACITY	194,900	100.0
PHINMA	81,375	41.8
Bacnotan	9,000	4.6
Central	6,875	3.5
Rizal	11,400	5.8
Solid	23,150	11.9
Hi-Cement	11,400	5.8
Davao Union	19,550	10.0
ALCANTARA	27,425	14.1
Alsons	14,425	7.4
Iligan	13,000	6.7
ZOBEL-ARANETA	34,500	17.7
F-R Cement	15,150	7.8
Titan	9,000	4.6
Fortune	10,350	5.3
INDEPENDENTS	51,600	26.5
Northern	19,150	9.8
Republic	14,500	7.4
Continental	5,250	2.7
Apo	4,550	2.3
Mindanao	4,550	2.3
Pacific	3,600	1.8

Source: Philcemcor

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Industry domination by the big players is quite pronounced when rated capacity is considered[5]. The biggest player is Phinma, which manages or controls six plants and 42 percent of the country's rated capacity. The two other big players are the Zobel-Araneta bloc (18% of capacity) and the Alcantara bloc (14 percent). Of the six independent firms, the largest is Northern Cement Corporation which has 10 percent of capacity.

These groups have a geographic orientation. Phinma- and Zobel-Araneta-controlled plants are mostly found in Luzon, while Alcantara's companies are located in the south. The exception is Phinma-owned Davao Union, located in Mindanao. Also, Zobel-Araneta has forayed into the Visayas market by rehabilitating Cebu-based Universal Cement, formerly controlled by the Durano family.

Concentration among the major players is even more marked when considering sales in geographical markets. Due to transportation difficulties, cement manufacturers tend to concentrate their sales within nearby markets. In addition, because of overcapacity, they have had since 1973 an informal arrangement dividing geographical markets among themselves, i.e., firms in Luzon (excluding Region V) could not sell to the Visayas and Mindanao (including Region V), and vice versa. This was only recently set aside because of shortages in Luzon.

An analysis of regional sales (see Table 4.7) demonstrates the effect of the agreement and also shows geographical niches more specific than that encouraged by the arrangement.

Phinma-controlled companies provided almost half the cement sold in the NCR, and 51 percent of the combined consumption of the Luzon area. Companies controlled by the Zobel-Araneta group added 16 percent of NCR usage and 18 percent of Luzon consumption, and will become even more prominent with the re-opening of Universal cement. The key players in the south are Alcantara, which supplied 40 percent of the cement in the Vismin area, and Phinma, which supplied the entire needs of Region XI and over half the needs of Region XII through Davao Union.

In summary, rivalry among the players is muted, with the Philippine market informally divided into regional units served by a dominant player. This agreement includes a production quota system which regulates and allocates output among the firms.

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[5] Rated capacity is used by Philcemcor as the basis for membership dues, and for allocating production quotas and distribution areas. It is also an input in the BOI's decision to maintain or withdraw incentives.

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Table 4.7
Domestic Sales by Region, 1989
(In Thousand Metric Tons)

	NCR	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Northern Luzon													
Bacnotan (P)	0	242	0	106	0	0	0	0	0	0	0	0	0
Northern	172	49	98	172	0	0	0	0	0	0	0	0	0
Metro Manila													
Central (P)	35	0	35	156	25	0	0	0	0	0	0	0	0
Republic	308	0	0	132	0	0	0	0	0	0	0	0	0
Continental	19	3	0	0	48	0	0	0	0	0	0	0	0
Rizal (P)	278	0	0	0	185	0	0	0	0	0	0	0	0
FR Cement(Z/A)	271	0	0	21	125	0	0	0	0	0	0	0	0
Solid (P)	412	0	0	0	275	0	0	0	0	0	0	0	0
Hi-Cement (P)	237	0	9	35	61	0	0	0	0	0	0	0	0
Southern Tagalog													
Fortune (Z/A)	64	0	0	0	259	0	0	0	0	0	0	0	0
Cebu													
Apo	0	0	0	0	0	0	0	197	0	0	0	0	0
Northern Mindanao													
Iligan (AI)	50	0	0	0	0	58	58	39	58	39	97	0	39
Mindanao	0	0	0	0	0	16	58	23	29	35	43	0	0
Pacific	7	0	0	0	0	26	20	26	33	0	26	0	0
Floro*	45	0	0	0	0	33	113	33	53	53	73	0	0
Southern Mindanao													
Grand Union(P)	5	17	0	12	0	60	69	26	49	41	12	301	41
Total	2,077	308	142	682	930	193	318	344	221	167	250	301	80

* Now under Alcantara.

Source: Philcemcor (Onoda, 1990)

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Threat of New Entrants

Five plants are undergoing expansion, projected to add almost 68 million bags of new capacity within three years. In addition, Universal Cement, with a rated capacity of 9 million bags, is about to reopen. These expansions have not deterred investors from registering four new plants with the BOI, which are estimated to add another 121 million bags of capacity by 1995 (see Table 4.8).

All of the new plants have foreign equity participation, and only one is known to have equity participation by an incumbent manufacturer. In sum, BOI-registered planned entrants and expansions are estimated to more than double the capacity in five years, although the accomplished capacity will probably be less than that planned.

Table 4.8
1991 BOI-Registered Cement Projects

	Name of Firm	Added Capacity* (in million bags)	Year of Operation	Affiliated Group
	Incumbents			
1.	Hi-Cement	7.2	1992	Phinma
1A.	Hi-Cement	7.2	1993	Phinma
2.	Bacnotan	11.4	1994	Phinma
2A.	Bacnotan	11.4	1995	Phinma
3.	Solid	13.2	1993	Phinma
3A.	Solid	13.2	1994	Phinma
4.	Davao Union	2.4	1992	Phinma
4A.	Davao Union	2.4	1993	Phinma
5.	Universal**	9.0	1992	Zobel-Araneta
5A.	Universal**	9.0	1993	Zobel-Araneta
6.	Northern	3.0	1992	E.Cojuangco
6A.	Northern	3.0	1993	E.Cojuangco
	Total	92.4		
	New Plants			Known Investors
1.	Grand	18.0	May 1992	Benedicto
2.	Bagawan	1.8	Jul 1992	
3.	Asia	62.5	Jan 1995	Tan Yu
4.	Millenium	25.0	Aug 1993	T. Creus
	Total	107.3		
GRAND TOTAL		199.7		

* Added capacities for incumbent firms and Grand Cement are based on Philcemcor projections. The rest are based on capacities registered with the BOI.
** Re-opening as Lloyds Richfield

Sources: BOI, Philcemcor, newsclippings

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Bargaining Power of Other Interest Groups

The influence of distributors over manufacturers was greatest in the 1960s, when diverse ownership in the industry caused intense competition among manufacturers. During this time, distributors could dictate prices and regulate supply. However, the succeeding consolidation of ownership, establishment of extensive distribution networks by manufacturers and, recently, cement shortages have tipped the balance of power in favor of producers. Now, distributors and dealers put up cash bonds before they can do business with certain suppliers.

Consumers are a potent interest group, as reflected in the maintenance of price controls. Moreover, the cement market becomes a political issue during shortages. The lifting of price controls in 1989 lasted just five months, with the new prices just marginally higher than they were prior to the lifting.

Suppliers of raw materials and substitute products apparently neither have bargaining power nor exert pressure on sectoral profitability. Reserves of limestone and clay, cement's principal raw materials, abound all over the Philippines, so its supply does not pose a problem for the industry. Gypsum is a by-product of the fertilizer industry. However, manufacturers find local gypsum of low grade, and must import high-grade gypsum. Coal supply used to be monopolized by PNOC Coal Corp. Now cement producers can buy from local and foreign suppliers, although government regulations require 55 percent to be sourced locally.

There is no effective substitute for cement as a raw material for concrete. As mentioned, it is superior to rival bonding agents such as Roman lime and hydraulic lime. In certain cases it gets some competition from wood (in residential construction), glass (building facades), and asphalt (road pavement) but this substitution is not significant.

Market Demand and Supply

Domestic and Foreign Demand

Cement consumption is highly sensitive to economic growth, tending to rise and fall faster than real GNP[6]. Cement consumption climbed steadily during the boom period of the postwar years through to the 1960s, from one million bags in 1946 to 68 million bags in 1969 (see Table 4.9). Subsequently, at the start of the 1970s the market slumped to 49 million bags at about the same time that capacity grew to 160 million bags. This overcapacity caused plant shutdowns and deterioration so that shortages ensued when demand picked up in the late 1980s.

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[6] Using simple regression, it is estimated that each percentage point change in real GNP results in a change in cement consumption of five percentage points in the same direction.

$$\text{Cement consumption growth} = -14.963 + 5.120 \text{ Real GNP Growth}$$
$$(21.917) \quad (0.561)$$

$R^2 = 0.65937$ n = 45   df = 43   data years = 1946 - 1991

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Table 4.9
Cement Consumption and Production, 1946 to 1991
(In 000 Bags)

Year	Consumption	Production
1946	1,241	1,342
1947	3,909	3,141
1948	7,350	2,843
1949	9,501	5,554
1950	7,938	6,997
1951	6,146	7,394
1952	6,005	7,516
1953	6,687	7,476
1954	6,333	7,476
1955	7,239	9,501
1956	11,386	10,444
1957	15,868	12,525
1958	15,623	15,303
1959	18,074	17,989
1960	18,995	18,949
1961	23,889	23,843
1962	22,586	22,654
1963	27,533	23,481
1964	32,543	29,200
1965	37,315	35,713
1966	39,711	39,364
1967	52,975	49,747
1968	62,421	61,631
1969	67,396	68,588
1970	56,675	57,794
1971	49,262	59,237
1972	54,633	62,015
1973	68,423	95,199
1974	67,870	87,134
1975	88,123	108,770
1976	84,468	105,733
1977	81,917	102,803
1978	84,777	105,022
1979	88,378	98,494
1980	91,162	112,904
1981	87,836	99,907
1982	86,881	100,874
1983	109,693	113,551
1984	83,494	90,935
1985	66,975	76,961
1986	78,197	82,065
1987	110,975	106,907
1988	135,000	133,824
1989	154,000	150,862
1990	184,000	N.A.
1991	170,000	169,000

Source: Philcemcor

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Cement consumption in 1991 is estimated at 170 million bags or 87 percent of capacity. The private sector accounts for the bulk of domestic consumption, although the government is the single largest consumer of cement.

During the period of chronic overcapacity in the 1970s, cement firms looked to the overseas markets. In that period exports, subsidized by the aforementioned export kitty, reached as high as 20 million bags per year, dropping gradually until no exports were made from 1988 to 1990 (see Table 4.10).

Table 4.10
Cement Exports, 1974-91
(In thousand bags)

Year	Exports
1974	19,112
1975	20,056
1976	17,666
1977	20,556
1978	20,587
1979	6,945
1980	19,859
1981	11,765
1982	14,791
1983	3,244
1984	3,524
1985	9,697
1986	2,618
1987	964
1988	0
1989	0
1990	0
1991	3,000

Source: Albarracin, 1991

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Domestic Production and Imports

Only in the late 1980s did production go over 80 percent of total rated capacity, even when taking into account the lower actual capacity of old plants (see Table 4.11). Capacity utilization by individual companies varies widely. For the period 1981 to 1986, Mindanao Cement posted a high of 112 percent utilization rate as against a low 45 percent utilization rate of Hi-Cement. Visayas and Mindanao firms generally posted higher rates than those in Luzon. The figures for each company are shown in Table 4.12.

Table 4.11
Clinker Capacity Utilization, 1981-89

Year	Rerated Capacity (000 tons)	Production (000 tons)	Utilization (%)
1981	5,640	3,971	70.4
1982	5,655	4,232	74.8
1983	5,670	4,334	76.4
1984	5,860	3,531	60.3
1985	5,208	2,839	54.5
1986	5,833	2,985	51.2
1987	5,015	3,408	68.0
1988	5,885	4,732	80.4
1989	5,966	4,975	83.4

Source: Philcemcor

Table 4.12
Capacity Utilization by Company
1981-86, 1987
In per cent of rated capacity*

Luzon	1987	1981-1986
Bacnotan	124	85
Northern	75	72
Central	125	79
Republic	106	90
Continental	44	51
Rizal	97	56
Filipinas (FR)	0	59
Island	0	69
Hi-Cement	95	45
Fortune	100	86
VisMin		
Iligan	114	86
Mindanao	123	112
Pacific	54	89
Davao Union	89	67
Floro	0	62
Apo	81	95

Source: Philcemcor

* Annual rated capacity is less than actual to allow for downtime due to scheduled maintenance, emergency repairs. Utilization rates may exceed rated capacity when downtime is less then shceduled or anticipated.

Imports alleviated cement shortages from 1987 to 1990, with a peak of 22 million bags in 1990. High international prices currently have made importations unprofitable. Delays in unloading at the ports, because of inadequate port infrastructure, add to the risks of importing cement. The retail price set for imported cement during the period of price controls have not significantly offset the risks. Import volumes of cement and clinker since 1987 are given in Table 4.13.

Table 4.13
Total Imports
(in thousand tons)

	Clinker	Cement
1987	45	165
1988	0	0
1989	328	141
1990	0	924
1991(Nov.)	159	0

Source: Philcemcor

Industry Outlook

Over the next decade, consumption is likely to increase. Onoda (1990) predicts that annual cement usage will reach from 225 million to 325 million bags by the year 2000, with 300 million as its "most probable" forecast. The study also foresees low export potential for the industry in light of competition from Indonesia as well as minimal excess capacity in the industry.

Philcemcor projects capacity to increase to 305 million bags by 1995 with the ongoing expansions, the reopening of Universal Cement and the opening of Grand Cement. Five new plants have also registered with the BOI, although a number of these are likely to be delayed, while others do not have definite completion dates.

Performance of Key Players

Ownership Structure

The cement industry began consolidating ownership during the market downturn of the 1970s. Previously, there had been almost as many players as there were plants.

Existing cement plants are predominantly capitalized by Filipino equity. Only six firms are funded in part, and none in majority, by foreign investment. Three of the firms (Bacnotan, Hi-Cement, and Davao Union) are part of the Phinma group. Foreign involvement in the industry is increasing, however, as reflected in the new cement firms being set up. The six existing firms with foreign participation and the extent of foreign holdings for each are given in Table 4.14.

The government had huge stakes in the sector primarily on account of DBP loans and guarantees. This in fact was one of the rationales explicitly stated in the law creating the PCIA in 1973. During the crisis years in the 1980s, government financial institutions again stepped in to save the industry by converting loans into equity.

Table 4.14
Foreign Participation in the Industry

Company	Foreign Participant	Extent of Holdings
Bacnotan	Phil. American General Insurance Co.	10%
Hi-Cement	F.L.Smidth	15%
	International Financing Corp.	15%
Davao Union	F.L. Smidth (Japan), Ltd.	9%
	F.L. Smidth	9%
	Industrialization Fund for Developing Countries	9%
Pacific Iligan	Holdergreen, Ltd.	40%
	Holderbank Financiere Glaris, Ltd.	23%
	Green Island Cement Co.	15%
Republic	Jardine Davies, Inc.	20%
	Lincoln Phil. Life Ins.	2%

Source: Onoda, 1990

In 1987, the DBP relinquished its equity holdings in a number of cement firms to the Asset Privatization Trust (APT). Most of these firms have been bidded out by APT.

Financial Performance

Philcemcor does not monitor the summary financial condition of the industry. However, publications such as the Top 1000 Corporations provide some historical indicators of individual firms' financial performance. Table 4.15 shows the rates of returns of industry players among the Top 1000 corporations. From this it can be gleaned that:

- Up to the late 1960s, the industry enjoyed high profits. This attracted new entrants and increased capacity.

- Starting in 1970, overcapacity characterized the industry. Many firms suffered losses from 1971 to 1973, until the government intervened partly to protect its stakes, and because the sector was a potential bottleneck to economic growth.

- From 1972 to 1982, many firms posted comfortable profits. The economic crisis, however, again led to a market slump and to industrywide losses.

- When the Philippine economy recovered in the mid-1980s and enjoyed a boom until 1990, cement shortages ensued. Industry profits became positive.
- The 1991 economic slowdown, which again depressed cement consumption, may lower profitability in the near term.

Table 4.15
Return on Equity, 1967 to 1990
Cement Firms Among the Top 1,000 Philippine Corporations
In Per Cent

A. 1967 to 1973

FIRM	Period of Relative Profitability			Period of Overcapacity, depressed demand			
	1967	1968	1969	1970	1971	1972	1973
Bacnotan	14.88	11.74	8.72	21.23	(3.75)	(3.03)	(3.15)
Northern				4.45	(117.30)	4.11	16.55
Hi-Cement		1.06	4.61	(1.91)	(82.61)	(264.97)	
Central/Luzon				(11.08)	43.79	(61.85)	(8.39)
Solid							
Rizal	30.96	8.10	(10.21)	(231.23)	(222.19)		
F-R	8.13	11.37	3.51	0.08	(15.56)	(19.87)	(1.18)
Titan							
Republic	15.69	12.60	3.82	(2.36)	(6.97)	(11.17)	(2.62)
Continental							(0.85)
Fortune					51.64	268.66	(16.51)
Universal	7.84	9.01	4.68	(1.51)	(51.48)	(641.19)	(23.44)
Apo	(12.21)	2.82			(15.81)	0.34	(15.64)
Pacific	5.66	4.08	(12.11)	(22.06)	(27.65)	48.98	
Alsons						1.79	(65.48)
Mindanao	4.61	1.67	(1.93)	(0.62)		(153.67)	11.98
Iligan					(17.08)		
Davao						5.55	

Table 4.15 (Cont.)
Return on Equity, 1967 to 1990
Cement Firms Among the Top 1,000 Philippine Corporations
In Per Cent

B. 1974 to 1981

	Period of Relative Financial Stability							
FIRM	1974	1975	1976	1977	1978	1979	1980	1981
Bacnotan	4.33	3.95	4.00	7.00	9.00	22.00	21.00	54.00
Northern	28.51	0.17	15.00	8.00	14.00	2.00		
Hi-Cement	(7.49)	0.30	(11.00)	1.00	5.00	0.20	0.40	
Central/Luzon	(8.97)	(7.00)	(315.00)	3.00	4.00	29.00	18.00	
Solid								
Rizal		(37.00)	0.11	2.00	5.00	41.00	26.00	7.00
F-R	0.67	0.06	2.00	7.00	6.00	10.00	8.00	2.00
Titan								
Republic	11.71	10.00	11.00	5.00	7.00	9.00	6.00	(3.00)
Continental	0.11	(0.94)	0.40	(1.00)	(0.10)	0.30	0.30	
Fortune	28.51	31.51	26.00	19.00	14.00	23.00	35.00	32.00
Universal	(55.71)	117.00						
Apo	(10.15)	(18.54)				18.00	13.00	4.00
Pacific		(141.23)		(121.00)		(5,445.00)		
Alsons	(60.91)	5.00	(99.00)					
Mindanao	5.09	13.27	20.00	12.00	3.00	5.00		
Iligan					(2.00)	2.00	3.00	0.20
Davao								

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Table 4.15 (Cont.)
Return on Equity, 1967 to 1990
Cement Firms Among the Top 1,000 Philippine Corporations
In Per Cent

C. 1982 to 1990

	Period of Economic Crisis				Period of Deregulation				
FIRM	1982	1983	1984	1985	1986	1987	1988	1989	1990
Bacnotan	5.00	4.00	6.00	4.91	3.11	7.31	9.29	6.21	0.07
Northern	(9.00)	(7.00)	(5.00)						
Hi-Cement	(3.00)		(5.00)	(4.29)	(2.84)	12.95	33.69	14.17	31.81
Central/Luzon	17.00	6.00	7.00	(4.42)	(7.89)	(3.52)	5.81	13.16	7.68
Solid							17.48	39.78	31.45
Rizal	14.00	5.00	9.00	(5.18)	11.10	30.78	38.75	46.45	34.47
F-R		(3.00)	(11.00)				0.68	(0.70)	2.11
Titan									
Republic				(0.51)	(0.48)	9.92	10.11	2.28	4.03
Continental		(2.00)	(2.00)	(3.32)	(0.01)	0.23		(9.57)	1.44
Fortune	20.00	13.00	1.00	(2.00)					
Universal									
Apo	2.00	2.00	(54.00)	(14.00)					
Pacific		157.00	(81.00)						
Alsons		532.00	95.00						
Mindanao	6.00	(4.00)	(18.00)		(83.65)	19.45	(44.58)	102.29	1.90
Iligan	1.00	(3.00)	(6.00)	(32.79)	(87.52)	61.39	23.16	29.93	32.98
Davao	(3.00)	(2.00)	(4.00)	(52.87)	(16.90)	1.26	8.21	6.71	18.28

Source: Business Day Top 1,000 Corporations

Industry Status/Issues

As noted, the cement industry is highly market-sensitive, tending to grow and fall more rapidly than the economy. Most plants are small by world standards. The economic-size plant (the size at which average cost is minimized) has been estimated by a BOI-commissioned study at about 1 million tons (25 million bags) of cement. None of the existing firms has yet attained this capacity. The industry is also characterized by obsolete technology and low energy efficiency.

As far back as 1980, the industry has been targeted for rehabilitation, aimed at conserving energy, with DBP making loans available. The World Bank (1986), however, observes that government-sponsored energy conversion programs proved to be expensive and contributed to their high indebtedness that was a big factor in the insolvency of firms during the crisis years.

Concessionary credit for the cement industry has again shrunk. Albarracin (1991) cites as an issue the lack of long-term financing for modernization of the industry. This is especially significant given that all the firms are close corporations with little scope to expand assets through equity. He regards price controls and regressive tariff structures as factors discouraging investments. The planned entry of several new players has coincided with price decontrols and tariff reductions.

Government Policy Interventions

Access to Credit

The government first intervened in the industry through grant of loans and guarantees in the 1950s and 1960s. A liberal loan policy implemented through the DBP was a catalyst for the sector's expansion in the 1960s. During the economic downturn in the seventies the government intervened to halt cutthroat competition by creating the Cement Authority, or PCIA. The DBP itself was involved in industry regulation, having representation in the PCIA as the industry's primary creditor.

It was again the DBP that extended loans for the sector's rehabilitation program in the 1980s. During the economic crisis the DBP bailed out these firms through the conversion of loans to equity. These assets were eventually transferred to APT, which in turn allowed former owners to buy back their debt at a 40 percent discount.

When part of the US$500 million industrial restructuring loan of the World Bank becomes available to the sector, the question becomes whether the industry can absorb any more indebtedness without an increase in equity. By lowering the default threshold of the firms, new debt increases their vulnerability to fluctuations in demand, which in the first place is difficult to project over the long term. Yet firms are forced to make long-term demand forecasts because equipment is capitalized over several years.

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Price Controls and Quotas

Except for a brief period in 1989, the government has controlled cement prices since 1972, until deregulation in November 1991. Prices were set by the Price Stabilization Council and later by the PCIA under the Marcos administration, and then by the DTI under the Aquino administration. Quotas were set by Philcemcor under powers delegated to it by PCIA.

As noted before, price controls and production quotas were instituted by government to sustain the industry during a period of chronic overcapacity. Inadvertently, they served as de facto limit prices, high enough to sustain incumbents but low enough to discourage entrants. It is likely that without price controls and production allocations, some of the inefficient firms would have been phased out earlier, and others would have been induced to become more efficient.

Still, many manufacturers complained of the price controls, because profitability was impaired without really benefitting the public. End-users gained little from price controls, because retailers found ways to circumvent them. For instance, the prices reflected in the official receipts differed from the true transaction prices. Additionally, some retailers made sales of cement contingent on the purchase of other materials priced at a premium. Builders with specific schedules frequently choose to bear these costs and risk penalties rather than incur project delays.

The lifting of price controls and the reduction of tariffs in 1991 are a signal to new investors. Several have responded, as reflected in the number of firms requesting for BOI incentives.

Import Controls

Cement was classified as a regulated commodity prior to 1989, with approval required from BOI in order to import. In March of 1989 this regulation was dropped, and tariffs on cement lowered from 40 percent to 20 percent, and later to 0 percent. Executive Order 470 restores the tariff to 20 percent effective July 1, 1991. Since 1987 any party has been allowed to directly import cement, but cement firms that import cement and clinker do so through Philcemcor, which coordinates the firms to prevent overimportation.

Incentives

The BOI grants incentives to the cement sector to encourage expansion, rehabilitation and modernization projects. Further, incentives are given to energy-related projects. Since 1989, eleven cement-related projects have applied for incentives to support rehabilitation and expansion plans with an aggregate cost of P3.86 billion.

It is significant to note that during the period of high regulation there was only one new entrant, Davao Union, which availed of the incentives. In contrast, after the deregulation, there have been at least five new entrants applying for BOI incentives.

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GENERAL ASSESSMENT

Policy-Induced Barriers

The public perception that a cartel exists in the cement industry can be attributed to the publicized consolidation of cement plants into concentrated ownership blocs, the close relations of Philcemcor with government regulators, and the lack of new entrants (until recently) despite cement shortages in the 1980s.

Indeed, until 1986 when the government gradually moved toward deregulation, the sector somehow presented a model of noncompetitive behavior. This was abetted by the following government policies.

- *Direct regulation of entry*

  Until its abolition in 1987, PCIA approval was required to establish a new cement plant or expand an existing one. Philcemcor assisted the PCIA in this mandate by monitoring the rated capacities of manufacturers and providing the PCIA information upon which to base its decisions. This direct restriction on entry with the influence of the trade association obviously was advantageous to the incumbents.

- *Market arrangements*

  The PCIA delegated to the Philcemcor the authority to establish and enforce sales quotas, distribution areas, and other marketing regulations. For instance, cement firms have been operating on the basis of a quota system wherein the manufacturers meet at least once a month to discuss the previous month's sales performance and set quotas for the following month.

  In addition, Philcemcor instituted a subsidy mechanism that covered incumbent firms' losses incurred when they (a) exported excess capacity at world prices lower than domestic costs, and (b) imported at world prices higher than domestic levels. This loss-sharing among incumbents discourages entry of efficient firms.

  Close relations between the government regulators and Philcemcor also mutes competition in subtle ways. At present, world prices are higher than domestic, and therefore one would expect firms to service this market first. However, the BOI, worried that firms would neglect the domestic market, has requested the industry to refrain from exports at the moment. Philcemcor officials say they have acceded to BOI's request as a concession to that agency. The effect of this agreement, of course, is to keep utilization rates at the status quo and limit opportunities for entrants.

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- *Limit prices*

  Uniform prices, first established in 1972, were originally pushed by producers and intended as price floors to remove cutthroat competition in an industry that had suffered three straight years of losses. Although uniform prices later evolved into ceilings imposed to protect consumers, they provided enough margins to sustain inefficient firms while discouraging new capacity -- a limit price, in effect.

  The cement business is cyclical, with firms expected to recover during the upturns the losses sustained during economic downturns. Price ceilings removed this compensating mechanism and served to discourage new entrants.

It may be fair to say that cement firms, through the Philcemcor, acted with what would be called "collusion" in ordinary circumstances. In this case, however, the actions of the industry had the imprimatur of the government through PCIA. Even after the PCIA's abolition, Philcemcor's market arrangements continue to be tolerated by government, this time represented by the DTI and the BOI. This tacit consent appears to have the characteristics of "capture" a la Stigler.

In hindsight, the government may have acted to protect its stakes or could have been motivated by a desire to maintain cement self-sufficiency so that the industry would not be a bottleneck to economic growth or a drain on foreign reserves. In the event, policy-induced barriers helped to block entry into the sector for almost two decades.

The PCIA abolition in 1987 coincided with the relaxation of the regulatory framework. Tariffs on imported cement were reduced and later totally eliminated, although EO 470 restores the cement tariff to 20 percent effective July 1, 1992. The lifting of price controls on cement last November 1991 reinforced the trend towards deregulation.

Structural Barriers

Huge Capital Requirements

Owing to high start up costs in what is a capital-intensive industry, the cement industry developed very slowly in the Philippines. Until 1952, only three plants were established, one of which was government-owned. It was not until the availability of government concessionary credit in the mid-1950s and 1960s that cement plants were set up in rapid succession.

Additionally, the fact that most of the capital was embodied in durable equipment specific to the industry was an exit barrier for the established firms. Because of the large exit barriers, incumbents chose to remain in the industry despite chronic overcapacity. At least for almost two decades, the incumbents found in government a ready ally, because of the latter's direct participation in the industry as creditor or shareholder.

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Economies of Scale

It is estimated that the average cost to produce cement is minimized when plant capacity reaches one million tons (25 million bags) of cement. At present none of the plants have reached this capacity. Expansion plans by incumbents reflect an effort to capture these scale economies. (Also, majority of the new plants being planned approach or exceed this capacity.) These incumbent expansions crowd out opportunities for new entrants. Thus, Philcemcor's own projections of capacity until 1995 ignore the planned entrants registered with the BOI, reflecting the belief that the expansions by the established firms as more than sufficient to meet projected demand.

Public Welfare Implications

The impact on public welfare is mixed. On the positive side Philippine cement presently costs less to produce than those of its neighbors except Singapore. However, this can be attributed to the low energy prices and subsidized interest payments in a capital- and energy-intensive industry. These conditions may not necessarily hold in the future.

Price controls have not quite insulated the public from rents imposed by sellers during shortages. Controls simply shifted the rents from the producers to the distributors. Controls kept dominant blocs of producers in regional markets from extracting rents. But distributors, some of whom are subsidiaries of producers, were able to circumvent controls and sell at black market prices, thereby gaining the rents themselves.

The recent decontrol of prices without a corresponding dismantling of the informal market arrangements raises the possibility that rents may continue to exist during shortages, except the producers may gain the rents this time.

Despite current low profitability in the industry, many incumbents have registered for BOI incentives to expand their plants. Of these expansions by incumbents, two are new plants wedded to existing support infrastructure. In addition, five new entrants are planned by 1996, of which only one has known equity participation by an incumbent manufacturer.

Because of long gestation periods and long useful life spans of equipment, the expansions in the cement industry are based on projections of demand and profitability in the long term. Thus, current low profitability has not acted as a barrier in this instance. What is significant, however, is that incumbents have not dominated the list of new entrants. The present tightness of long-term credit has, in fact, been a hindrance to the incumbent firms, all of which are close corporations already significantly leveraged and without recourse to expansion through new equity.

Policy Directions

The simplified figure below maps the identified barriers to entry according to prospects of removal, and the public welfare impact of removal.

Ideally, reforms are prioritized according to those which yield the greater benefits and which have the greater likelihood of succeeding in being passed and implemented.

Figure 4.1 Public Welfare Benefits and Prospects of Removal of Barriers

PUBLIC WELFARE BENEFITS	PROSPECTS OF REMOVAL: LOWER	BETTER	COMPLETED OR IN PROGRESS
BETTER	-huge capital requirements (removal requires efficient capital markets) -economies of scale (removal requires development of export market)	-government-tolerated market arrangements (removal requires political will; welfare impact direct)	-direct regulation of entry
LOWER			-government-mandated market arrangements (benefits from removal are minimal because of still existing government-tolerated informal arrangements) -limit prices (lifting of price controls yet to be accompanied with import liberalization)

The reforms that have already been completed or are already in progress are (1) the removal of direct regulation of entry, (2) the lifting of price controls, and (3) the abolition of the Philippine Cement Industry Authority (PCIA). However, the impact of the latter reform is dampened because although there is no longer an authority to mandate protectionary market arrangements, the government continues to tolerate or overlook informal collusive market arrangements. The proposed policy directions are as follows:

Reevaluation of government tolerance of informal market arrangements

Among other existing barriers, it is precisely this government tolerance of market arrangements that has the better prospect of responding to reforms.

Continued maintenance of liberalization of import restrictions

With regard to the lifting of price controls, the relaxation of import restrictions must continue to be maintained to help insure competition among domestic producers. Other barriers will be harder to overcome. The solution to huge capital requirements in the industry will have to wait for the development of more efficient capital markets in the Philippines or rapid investment flows.

Liberal foreign investment policy

Given the highly capital-intensive nature of the industry and the undesirability of returning to the concessionary credit policies of the 1960s, a more liberal foreign investment policy allowing majority ownership is proposed in order to augment local capital and encourage the infusion or transfer of new technology.

Expansion of export markets

The industry must explore ways to expand the market beyond domestic boundaries, because economies of scale continue to remain an issue. None of the present plants are near what is estimated to be the minimum economic size -- a capacity of 1.0 - 1.2 million tons yearly.

While incumbent plants can reduce average costs by expanding, new plants that come in at the minimum economic size and with new technology can be competitive with existing plants. Because expansion of existing plants is cheaper and faster to do than starting a new plant, incumbents have an advantage. However, with an expanding market, quickness of startup becomes less of an issue.

Research Areas

The following are the proposed areas for further study.

Quantification of public welfare impact of barriers to entry

It way be worthwhile to measure the consumer surplus loss due to rents related to entry barriers. Such a quantification may strengthen the arguments for reform and reinforce the political will to pass such reforms.

Study of family rivalry across industries

Many of the families involved in the cement industry have interests in other industries. It is not uncommon for families to be actual or potential business rivals in more than one industry. An area to explore may be the effect that family rivalry across industries may have on a firm's behavior in an industry. For instance, how is a firm's planned entry into an industry affected by the threat of retaliation in another industry?

V IRON AND STEEL MAKING

BACKGROUND

Definition of the Industry

The iron and steel industry may be defined as a sector primarily involved in the manufacture of billets and ingots, flat products and nonflat products.

The manufacture of flat products involves two processes, cold-rolling and hot-rolling. Cold-rolled products include galvanized iron (GI) sheets, tinplates, cold-rolled sheets while examples of hot-rolled products are plates, pipes and tubes, and hot-rolled sheets. On the other hand, non-flat products consist of steel bars, wire rods, and structural shapes.

Description of Technology

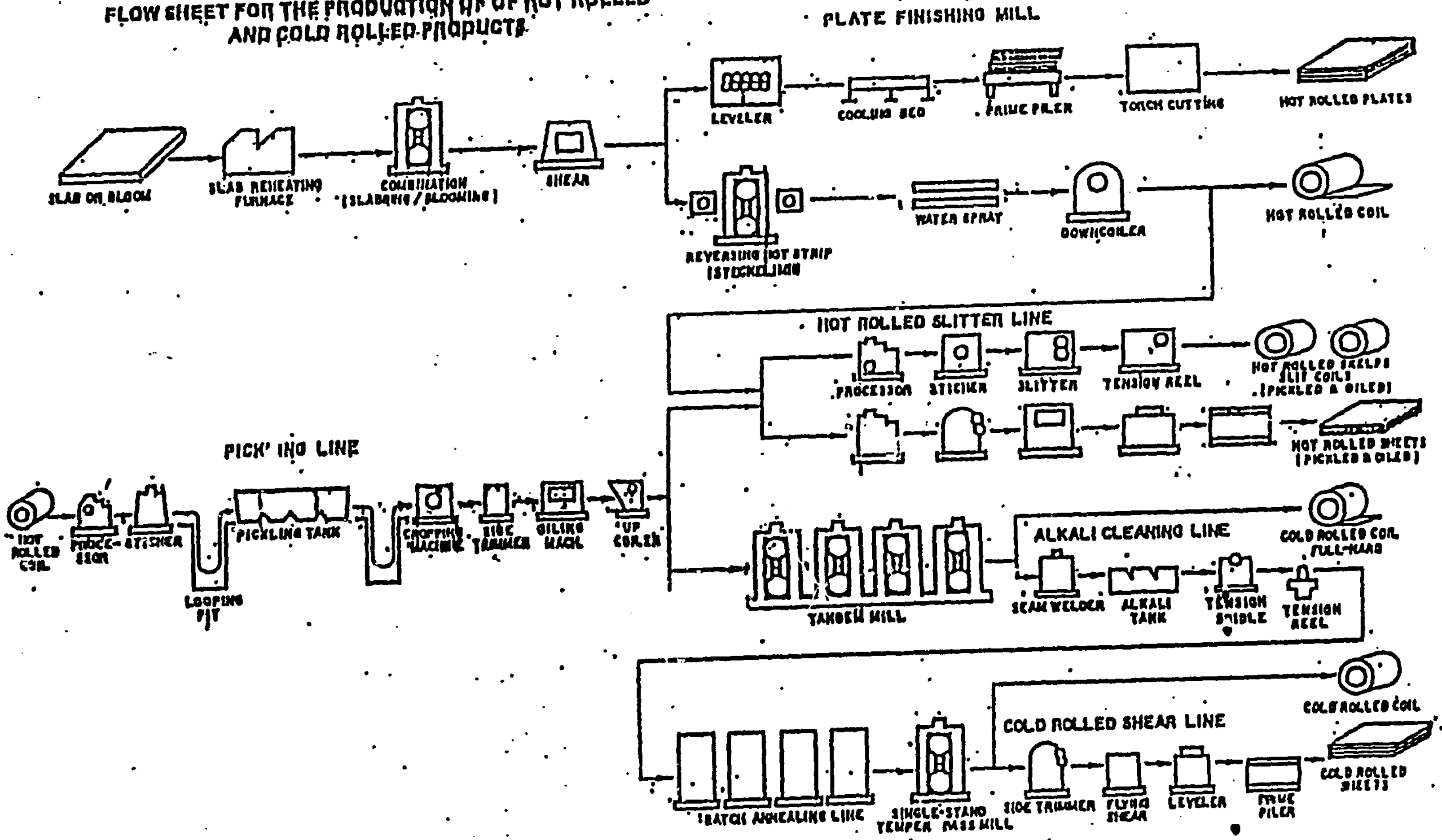
Industrial organization (IO) issues in the steel industry are closely linked to technological questions. These also form the basis for many of the arguments in the long-standing debate on the steel industry, whose development, for some, has assumed the dimensions of a political-economic symbol of industrialization.

Figure 1 gives an idea of the processes and products associated with the steel industry. To facilitate understanding, a coarser classification between flat and nonflat products is used. As Figure 1 shows, flat products are produced mainly using imported coils and slabs, which then pass through the hot- and cold- milling processes to produce pipes, tinplates, galvanized iron sheets, plain sheets, and plates.

On the other hand, producers of nonflat products such as bars, rods, wire, nails, structural shapes, etc. are fed by both imported and locally produced blooms, ingots and billets. Domestic production of billets and ingots relies on the use of scrap metal, again both imported and domestic.

The present technological process is truncated between simmering and pelletizing on the one hand, and melting on the other, owing to the absence of facilities (blast furnace or direct reduction) that would convert iron ore into pig iron that would feed into the melting process. As a result the output of iron ore mining is still exclusively exported.

FIGURE 1
FLOW SHEET FOR THE PRODUCTION OF OF HOT ROLLED AND COLD ROLLED PRODUCTS



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INDUSTRY STRUCTURE

It will be seen that firm-concentration is highest in hot- and cold-milling, as well as tinning, where the only producer is the government-owned National Steel Corporation (NSC). This has come about as a consequence of the historical development of the industry and government policy, as will be discussed further below. This has effectively given the NSC a dominant role in flat products, especially in the upstream intermediate products..

In melting, on the other hand, there were 12 companies operating as of 1989, with a total installed capacity of 718,000 MT. Of this the NSC accounted for 300,000 MT. There were 31 companies in bar rolling (516,000 MT capacity); eight companies in rod rolling (271,600 MT capacity); and six companies in angles, shapes, and sections (capacity 151,400 MT). There were eleven companies in galvanizing (451,000 MT total capacity) and twelve companies in pipe and tube production (322,000 MT capacity).

The markets served by NSC, as well as their relative importance, are shown in Table 5.1. Notable here is the degree of integration achieved. As much as 70 percent of NSC's output of hot-rolled products passes into its own cold-mill, with the rest being sold to others. The output of cold-milling, in turn, is sold mainly (72 percent) to galvanizers, to be turned into galvanized iron (GI) sheets; some 16 percent of cold-rolling output goes into NSC's own tinning line.

Table 5.1
Sectors Served by National Steel Corporation (1989)

Sectors	Percentage
1. Hot-rolled Products	
Cold-rolling (in-house)	70
Pipe and tube makers	18
Fabrication	11
Shipbuilding	1
Total	100
2. Cold-rolled Products	
Tinning lines (in-house)	16
Galvanizers	72
Drums	3
Appliances	2
Transport and Fabrication	7
Total	100
3. Tinplates	
Food canning	46
Liquid-milk canning	27
Crown caps	11
Industrial cans	11
Others	5
Total	100

Source: Metal Industries Research and Development Center, 1989

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GENERAL ASSESSMENT OF ENTRY BARRIERS

Excess Capacity

The rise of entry barriers in the steel industry can be understood best in the context of the industry's history. Broadly speaking, the industry has proceeded along a course of backward integration, from downstream products to upstream products.

A crucial episode for the industry was in 1962. In 1968, the government supported the Jacinto group in the setting up of the country's first integrated mill in Iligan (Iligan Integrated Steel Mill Inc.) with a capacity of 250,000 MT. Almost simultaneously, however, the Elizalde Rolling Mills (Elirol) put up another cold-rolling mill in Pasig. There was clearly overcapacity in the industry at that point. This was a clear case where demonstrable excess capacity did not serve as a sufficient deterrent to new entry.

The DBP foreclosed on IISMI in 1974 and in this manner the NSC was formed with the IISMI facilities as its core. Some anecdotal testimony suggests that partisan political considerations may have played a role in the decision to move against the Jacintos. In 1977, the NSC also purchased the Elizalde cold-rolling mill, thus making it the sole producer of cold-rolling mill products in the country.

In the late 1960s through the early 1970s, the IISMI augmented its cold-rolling facilities with hot-rolling mill facilities. In the mid 1980s, NSC expanded these, established a billet-making plant, and acquired a tinning line. The capacities are shown in Table 5.2.

Table 5.2
NSC Annual Capacity (000 mt)

	Old	New	Ave.* Prodn.	Capacity Utilisation
Cold mill	250	700	260	37%
Hot mill	250-300	650	238	37%
Tinning line	120-140	130	94	72%

Source: SGV (1989); MIRDC (1980).

Given the levels of demand prevailing in 1985-88, therefore, it will be seen that average production in 1985-86 had roughly reached levels allowed by the old capacity. Given the growth of the industry, the expansion of capacity was certainly warranted. What is at issue, of course, is whether the additional capacity necessarily had to be undertaken by NSC itself and not by some other firm.

As it is, however, after the NSC's expansion plan was completed in 1987, it is evident there will continue to be large excess capacity in hot- and cold-rolling over the next few years, and this will serve as a disincentive to potential entrants. That the additional investment in capacity is physically located in the same area (Iligan) as the existing facilities also reinforces the entry and mobility-barrier of excess capacity, since it becomes more difficult to justify the break-up of the ownership of the complex into smaller firms.

Potential entrants are the Jacinto family interests, the previous owners of IISMI, which are making a comeback partly through judicial moves and partly through the threat of competing investments. The Jacintos are interested in setting up an integrated steel mill, also in Iligan, in cooperation with mainland-Chinese partners (reportedly the Shougang Group), a blast furnace with a 1 billion ton capacity. These plans run up against the NSC's own plans to put up an integrated steel mill itself.

The NSC's more ambitious plan for a blast furnace with a 2.9 billion ton capacity, is estimated to cost US$ 1.9 billion, which cannot be raised from NSC's earnings alone. For this reason the NSC had planned to privatize some 25 percent of its shares as a means of financing. The Jacinto group, however, have sought to block the NSC move -- with initial success, as seen in an injunction by the SEC -- by bringing up the question of their old ownership of shares in IISMI.

A scenario that is likely to occur is that the NSC may continue its hold on hot and cold milling, while -- owing to its present financial and legal difficulties -- it may have difficulty in backward integration according to its earlier plans. Private sector agents such as the Jacinto group may then pre-empt the NSC's moves for backward integration. What might conceivably occur then is either a bilateral monopoly should arise between the Jacinto Group and NSC; or that the Jacintos themselves could succeed in taking over NSC. In the first instance, competition in the industry is likely to sharpen, although the NSC would always have the recourse of importing rather than buying from the prospective blast furnace. In the second scenario, concentration is likely to increase.

Policy-Induced Barriers and Rationale

A recurrent concern of the government since the 1960s has been the goal of setting up an integrated steel mill, and this has constantly played a major influence in the decisions pertaining to the NSC. With the formation of the NSC, the overriding objective has been the gradual backward integration of the industry. For example the integrated steel mill was ranked as one of the "eleven major industrial projects" under the Marcos regime.

Even earlier, however, the Iron and Steel Authority (ISA) was created by Presidential Decree 272 on 10 August 1973. Its members were the Chairman of the Board of Investments, Ministers of National Defense, Finance, Trade and Industry, the Chairman of the Development Bank of the Philippines, the Central Bank (CB) Governor, and two private sector representatives. The life of the ISA was extended in 1981 (Executive Order 555) and it was finally abolished only in 1988.

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Imports of iron and steel were regulated beginning in 1975 under MAAB 36, initially with the stated purpose of heading off speculation. The CB focused on the regulation of iron and steel in order to stem the outflow of foreign exchange, since these products were the fourth major imports and could be stored, hence making it prone to speculation. The approving agency, the CB, delegated the monitoring task to ISA which would allocate based on estimates of future demand and projected increases in production. The 1981 quantitative restrictions imposed on iron and steel placed them under the authority of the ISA. The guidelines stated that the ISA would "determine the individual semiannual or annual import level of registered importers on the basis of the prior years' importations..., plant capacity, established local market in the case of importer/suppliers, etc."(MIRDC 1980).

Anecdotal evidence suggests that under the quota allocation system the NSC got full allocations from CB, while others obtained only partial allocations. This was beneficial to NSC which produced intermediate goods. The point is that imports to others were restricted, enlarging the domestic market for NSC. After the pooling system ceased, NSC requested that regulation be continued. Thus from the original rationale of preventing speculation, there was a change to a goal of industry protection.

With NSC a domestic monopoly in the hot- and cold-rolling and tinning stages, the only competitor has been foreign imports. As a result the principal entry barrier induced by policy was the regulation of imports. Finally, the fact that the NSC is government-owned also poses some problems to an individual entrant which is less well-connected.

Digression on Quotas

Nontariff measures have been the principal instrument in the subsidization of the NSC. At this point it is useful to make a short digression on the analysis of the effects of quotas under monopolistic conditions. The discussion in Helpman and Krugman (1989) regarding quotas and domestic monopolies is particularly interesting. As long as the quota is less than the amount that would have prevailed under free trade (or trade inclusive of tariffs) in effect it allows the domestic monopolist to set price.

The quota divides the demand curve confronted by the monopolist into two parts. Let the entire domestic demand be denoted by Q(p), where p is the price as charged by the domestic monopolist; let m denote the import quota as determined by the government and P be the border price. If the monopolist sets price above the landed price, then it obtains Q(p) - m. If it sets p at or below P, it obtains Q(p). Under a quota, therefore, the dominant firm maximizes profits by adjusting its decisions conditional upon a quota being set.

From a political economy viewpoint, it is interesting how the protection afforded a monopolist by a quota is different from the protection afforded by a quota. Suppose for simplicity the monopolist's costs are such that marginal equals average cost, for all quantities produced below capacity. A tariff then either allows the firm to be established (i.e. when the tariff plus the world price equals or exceeds average cost), in which case it replaces all imports; or the industry fails to be established, in which case the whole market is supplied by imports. Furthermore, the government by setting the tariff, sets a price ceiling which the monopolist must adhere to.

In the case of quotas, however, the market may be shared between local producer and imports, without one necessarily driving away the other; the result depends on the amount of the quota which is set. For another, under quotas, the initiative for price changes lies not with the government but with the monopolist.

Recent Developments

Imports of iron and steel were finally liberalized in 1986 under CB Circular 1106. Furthermore, the primary and secondary processing of ferrous metals was placed under the investment-priorities plan in 1991. In recent years, therefore, there has been some movement towards removing the explicit policy instruments which give protection to NSC. These developments have been part of the overall liberalization pursued by the government under the structural adjustment program. On the surface, therefore, it would appear that the whole issue has become moot.

The matter is not as simple, however, considering the fact that through the previous privileges accorded NSC and the consequent first- mover advantage it has gained, further entry in the industry is effectively barred owing to the excess capacity that has currently been built up. Concretely, for example, NSC is in the pre- eminent position to take advantage of the incentives offered to the steel industry under the investment priorities plan -- and reaffirmed in the Iron and Steel Industry Act -- since it has had a headstart in complementary investment.

The main concern of NSC in the past few years has been to expand capacity further and in particular to integrate backwards.

Public Welfare Implications

The crucial question from a welfare viewpoint now turns on (1) the level of profits NSC has made or is making and (2) relationship between the border price and the domestic prices NSC charges.

As it is the NSC has more or less consistently improved its profits and is among the most profitable firms in an industry that is generally plagued by excess capacity leading to severe price competition (See Table 5.3). The rationalization of the industry is an improvement over the situation in the late 1960s. On the other hand, the rationalization will have been bought at the expense of the downstream users, through higher prices paid for inputs as a result of quotas. Studies in the late 1970 by the MIRDC and the World Bank (1979) talk of high rates of effective protection for the steel industry.

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Table 5.3
National Steel Corporation
Financial Performance
1974-1989

Year	Income/Assets	Income/Equity
1974	-0.12	-2.69
1975	-6.20	43.75
1976	4.96	16.41
1977	1.49	5.27
1978	0.95	4.39
1979	0.19	1.24
1980	0.37	0.69
1981	2.42	5.01
1982	3.90	10.49
1983	4.53	13.52
1984	5.90	15.74
1985	5.00	11.00
1986	5.00	10.00
1987	5.00	12.00
1988	5.80	13.80
1989	2.70	6.30

Here an empirical test of the effectivity of quotas in sustaining the profits of NSC is attempted by testing the following equation:

$$r = f(BE1, BE2, BE3, GDP, \ldots)$$

Given the hypothesis that the regulation of imports represented the principal method for financing the monopolist, import shares for the different output groups produced by the NSC is used as proxy for the entry barriers. The relationship is tested through time. The hypothesis is that the rate of return should vary inversely with the share of imports in consumption for the various product groups, namely hot-rolled products, cold-rolled products, and tinplates. Income or GDP is used as a scale variable. This is analogous to the typical model used in cross- section analysis of entry barriers (see, e.g. Schmalensee, 1989). In this case, however, this is applied longitudinally for a single firm.

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The following equation was arrived at:

SAMPLE 1974-1988

$$ROE = -131.81936 - 0.5042327^{**}\ MSH1 - 0.2358634^{*}\ MSH2$$
$$\quad\quad (-2.39) \quad (-1.9898) \quad\quad (-1.6071)$$

$$+\ 0.0017272^{***}\ GDP + 30.597824^{*}\ DUM$$
$$(2.7745) \quad\quad (1.7341)$$

R-squared = 0.585156; S.E. = 11.16724
Adjusted-R = 0.419218; F = 3.526360
DW = 2.20

***significant at 5 percent
**significant at 10 percent
*significant at 15 percent

MSH1 is significant at ten percent; MSH2 at fifteen percent; RGDP at five percent, and DUM at fifteen percent. DUM is turned on from 1974-1980.

MSH1 is the share of imports of imported cold-rolled products in consumption; MSH2 is the share of imported tinplates in consumption. It is notable as well that the import-share in hot-rolled products does not appear significant. The reason is obvious: hot-rolled products are also an input to NSC's cold-mill, and since NSC has a monopoly in that line, the entry and use of such products is largely at NSC's discretion, reducing it to a make-or-buy decision.

Policy Directions

It has been the desire of the industry, with tacit government support, to integrate backwards. This has become more intense under the more open liberal environment of the Aquino government. Currently, there are two contending parties, namely NSC and the Jacinto group, wanting to put up an integrated steel mill, but both are hoping that only one integrated mill will be approved by BOI, given their own forecast of capacity vis-a-vis demand, and each one is hoping to be selected. There are two complementary policy measures that the government could do with respect to this sector. One is to immediately initiate the privatization of NSC. Given its outstanding past financial performance, many investors would be interested in buying shares of NSC.

The other is to delist the industry from the 1992 IPP list so that new entrants could come in without expecting government incentives and protection. The private sector has a better way of determining the balance between supply and demand in the medium and long term. The privatized NSC and new entrants will then be placed on an equal footing as far as incentives are concerned. Any first-mover advantages currently enjoyed by NSC can be offset by new entrants through various means such as technology, organization, market diversification, choice of location, marketing tie-ups with foreign firms, etc.

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Research Areas

There are two important issues that need to be closely examined to aid in the formulation of a rational policy for the steel industry. One is to examine the impact of the recent import liberalization of iron and steel on NSC. It is imperative to measure the extent of the reduction of protection on NSC and to examine its responses to relatively more competitive environment. The other is to review the experiences of several developed and developing countries with respect to the establishment of a fully integrated steel mill. It would be useful to find out whether government intervention or market mechanism played a role in the establishment and determination of the number of integrated steel mills as well as assessment of their performance.

VI MANUFACTURE AND ASSEMBLY OF MOTOR CARS

BACKGROUND

Definition of the Industry

The Philippine automotive industry is composed of firms engaged in the manufacture and assembly of passenger cars, trucks and motorcycles, and parts thereof. Passenger cars, the subject matter of this case study, refer to motor vehicles of whatever type of body with a maximum of six seats, and are used primarily for the transport of persons. Passenger cars are distinguished from commercial vehicles, which are primarily designed for the transport of goods regardless of their carrying capacity.

There are three identifiable groups within the domestic car industry: (a) car manufacturers who assemble or put together the different parts of a car from imported completely knocked-down (CKD) components as well as locally-sourced parts; (b) car importer-distributors who import and distribute completely built units (CBUs); and (c) car parts and components manufacturers. This study focuses on the first. It has been the target of the government policy to increase the domestic value added in the car industry.

Economic Importance of the Car Industry

Car manufacturing is an important subsector of the Philippine manufacturing sector. Purchases of local parts and components alone reached ₱ 1.6 billion in 1990 from 1988's purchase figure of ₱ 362 million (see Table 6.1).

Table 6.1
Purchases of Local Parts and Components
by CDP Participants

Year	Amount (in ₱ million)
1988	362
1989	953
1990	1,596

Source: Board of Investments (BOI).

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Car manufacturing's importance to the economy can also be seen in its contribution to employment (see Table 6.2). Even though direct employment provided by the car manufacturing industry is quite small (a little over two thousand in 1990), owing to its import and capital-intensive character, indirect employment through the various forward and backward-linked industries is not inconsequential. Ninety percent of a car is metal, hence the development of the car industry can give a big boost to the metals and engineering industries. Moran (1991) cites employment of 61,000 and 75,000 for 1988 and 1990, respectively The components and parts manufacturers alone employed in 1990 some 40,000 people all over the Philippines. This figure is expected to double in 1992.

Table 6.2
Employment Contribution of CDP Participants (1988-1990)
(in Million Pesos)

Year	Total Payroll on Payroll	Tax Withheld of Employees	Total Number
1988	44	5	1,051
1989	121	15	1,709
1990	31	24	2,156

Source: BOI.

In terms of its contribution to the government coffers, the car industry is not exactly insignificant. For the period 1988 to 1990, it contributed about ₱5 billion to the national income in the form of taxes and duties and another ₱44 million came from taxes withheld from the car assembly workers (see Table 6.3). In terms of foreign exchange earnings, the parts industry earned US$204 million in 1990.

Table 6.3
Taxes and Duties Paid by CDP Participants (1988-1990)
(in Million Pesos)

Year	Corporate Income Tax	Value Added Income Tax	Excise/ Ad Valorem	Duties	Total Taxes and Duties
1988	121	312	527	356	1,317
1989	267	768	1,315	1,059	3,409
1990	266	941	1,443	1,183	3,833

Source: BOI.

On top of all these, the industry provides skills training in car manufacturing as well as in the various metals and engineering industries that are linked to car manufacturing, e.g., machining, welding -- that are transferrable to other industries.

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The Car Manufacturing Process

Car manufacturing basically involves the assembly of numerous (as many as 10,000) car parts and components. In the Philippines, most of these parts are imported. Some of the local parts may be produced by the assembler or manufacturer (e.g. some assemblers have set up their stamping and transmission plants), but most are produced and supplied by parts manufacturers with whom the assembler is tied up through sub-contracting or other arrangements. Parts sourced locally make up around 45 percent of the value of the car, according to a key informant.

A description of the manufacturing process at Nissan Motors, Inc., shown below, may be taken as representative of car assembly operations in the Philippines (see Box 6.1).

Box 6.1 The Car Manufacturing Process

The car making process is subdivided into three (3) major shops or work areas: body shop, paint shop, and car erection.

Assembly starts after CKD packs which are imported from Japan have been uncrated. The manufacturing process starts at the sub-assembly jig section of the body shop. Here the rear wheel housing, inner panel, side panels, body sides and flooring are constructed or put together. Primer coating is applied to all of the previously mentioned parts except on the flooring and body sides.

The main assembly jig, which immediately follows, is concerned primarily with metal finishing, which involves brazing and sanding of body sides and flooring. Hoods, fenders, doors and trunks are also attached here. Inspection of the work just done is also performed here; if the work passes quality inspection, red primer painting is done at this stage. Nissan uses gauge 1 to 1.2 metal for the flooring and gauge 0.8 for the body panels.

Body shells from the main assembly jig then undergoes metal preparation prior to degreasing and phosphating in the painting shop. Metal preparation is done in order to remove stubborn dirt. Phosphate is applied to ensure proper paint adhesion. The car body is manually rinsed after application of phosphate and the underbody receives a grey primer application before undergoing a drying process in an oven.

After coming out of the oven, the car body is wheeled in (through all the previously mentioned process, the car body rides in a skid adaptor, which could be likened to a dolly) to the body sealing part of the painting shop. Joints of the car are sealed with a sealing gun at this stage to prevent rust. The car's underbody receives a coating after the sealing job is finished. The whole structure of the car again undergoes another drying process.

The body of the car is sanded using demineralized water upon termination of the drying stage. Sanding also commences at this stage to ensure evenness of paint and paint adherence before topcoat application. The demineralized water, on the other hand, minimizes rust contamination that could come from mineral sources usually abundant in an ordinary tap water. The car shell again enters the drying oven after sanding. Asphalt silencers are then attached as an intermediate step to topcoat preparation and application.

In final painting phase, topcoating, the entire car structure again enters the drying oven once the top coating is performed. If there are blemishes and other imperfections in the car body, the check and repair section takes over to have the aberrant car undergo another sanding, until reaching the topcoat stage again. Car bodies that pass the trained eye of quality control inspector (those wearing yellow caps in Nissan) progress to the body waxing section, where they undergo rustproofing.

Car erection is the final part of the assembly process. It is subdivided into three (3) distinct lines: (a) trimline; (b) chassis line and (c) final line.

- The trimline has 10 stations responsible for attaching different parts such as wiring harness, carpets, lights, dashboard, bumper, side mirrors, and airconditioning system.

- The chassis is further subdivided into Underbody A and B. Underbody A attaches the fuel tank, suspension system, brake line, fuel line, stabilizer bar and power train system. Underbody B, or the engine mounting section, fits the engine that comes from the engine sub- assembly using hydraulic lift that hoists and bolts the completed engine to the car body from the underside of the car. After the engine is mounted, the car goes into the engine completion/running section. It is also here that seats and headlights are supplied to the vehicle. The tester line is the penultimate stage of the chassis line. In this line, the car undergoes quality control inspection to test camber correction/setting.

- The final line tests whether the car can withstand heavy rain (through a water leak test that mimics a deluge); if the car is roadworthy; and retouching newly spotted defects. This line terminates at the final preparation phase when the newly-built car undergoes final adjustments.

After hurdling the final line tests, the car is brought into the buy-off point where the marketing department takes possession of the car and the manufacturing process ends.

The assembly process in the two other plants (PAMCOR and Toyota) differs slightly with that at Nissan. Instead of car bodies being sprayed with paint and rustproofing material, they are dipped, resulting in a more thorough and penetrating application of the solutions.

It takes an average of 40 manhours to produce one car at Nissan. The CKD parts, on the other hand, constitutes 60 to 70 percent of the total cost of the car. The dealer's margin is estimated to be around 20 percent.

Car assembly is a capital-intensive process, although in the Philippines (at least at Nissan Motors), many operations have not been completely automated and mechanized. This is unlike the car manufacturing process in the more advanced countries where robots have practically taken over the routine operations like welding, assembly, and painting.

Emergence of the Industry

Early Beginnings

The present car manufacturing industry has its immediate postwar origins during the 1950s and 1960s when a number of local as well as foreign firms not only imported CBUs but also started assembling imported CKDs. But long before that, cars and trucks had been imported in CBU form into the country, principally by E.C. McCullough and Co. which then held Ford Motor Company's franchise in the Philippines.

Import controls during the 1950s, however, made the continued importation of CBUs difficult; this gave impetus to the start of assembly operations in the country. The first assembly plant, FABAR, Inc., was established in 1951.

By the late sixties there was already a proliferation of assembly plants. By one count, there were 40 assemblers producing and selling as many as a hundred different models of cars to a domestic market that was only slightly larger than 20,000 units (total CKDs and CBUs) a year.

As a consequence of the industry's intensely competitive structure, the viability of particular firms and of the industry as a whole became problematic. The precarious situation of the car industry was aggravated during the late 1960s by the foreign exchange crisis which forced a cutback in the importation of car parts, CKDs and CBUs. Also as a result of the floating exchange rate which was adopted in 1970, car prices increased drastically, depressing demand from an average of more than 22,000 units in 1968 and 1969 to less than 9,000 units in 1970.

Most of the seven biggest car firms in the country -- Chrysler, Delta Motors, DMG, Inc., Ford, Renault, Universal Motors, and Yutivo Corporation -- performed poorly in 1971. Chrysler, in particular, suffered losses for five consecutive years from 1967 to 1971.

During the early seventies, pressure mounted for some form of restructuring of the motor vehicle industry. A number of industry position papers came out calling for the government to rationalize and provide incentives to the industry. Government officials, and in particular some of the technocrats who were drawn to the Marcos government, increasingly articulated and championed the rationalization of the car industry.

The Progressive Car Manufacturing Program (PCMP) was the government's response to the aforementioned situation in the car industry. The PCMP was formulated during the early seventies and implemented by the Board of Investments (BOI) in the third quarter of 1972. This was replaced in 1987 by the Car Development Program (CDP). Both programs reflect government moves to "rationalize" the industry.

Progressive Car Manufacturing Program

The PCMP aimed to: (a) develop a domestic car industry that increasingly made use of locally made parts; (b) save/ earn foreign exchange through reduced importation of CBUs and the export of locally-produced cars; and (c) encourage the development of a local parts and components manufacturing industry.

To advance these objectives, BOI moved on two fronts. First, considering the small domestic market for cars, it sought to limit the number of participants in order for the industry to attain economies of scale. Applying a set of criteria like local content utilization, production capacities, export potential, BOI pruned the number of accredited car manufacturers from seven to four and later increased it to five, namely, Ford Philippines, General Motors (GM) Philippines, Inc.; Chrysler Philippines Corporation, Delta Motors Corporation, and DMG, Inc.

To the PCMP participants, the BOI offered tax, tariff, credit and foreign exchange allocation to encourage the local assembly and manufacture of cars and spare parts and at the same time discourage the importation of whole cars and protect the participants from new entrants.

Through a system of "deletion allowances", participants were allowed to deduct from the applicable duties the value of domestically-produced components; through this, car manufacturers were encouraged to progressively substitute domestic for imported parts and components. To encourage the substitution of locally-produced parts for imported ones, lower tariffs and duties were imposed on car parts and components as compared to those applicable to CBUs.

The guidelines for the PCMP were revised in 1982 in response to the poor performance of the industry during the late seventies and early eighties. Among the more important provisions of the revised guidelines were: (a) the prohibition of the importation of CBUs even on a no-dollar basis; (b) limitation in the number of models to three (BOI actually wanted only two); (c) a requirement that CKD price should not be more than 85 percent of the CBU price in the source country; (d) revised local content requirement, including a prohibition against carryover of previous year's excess local content; (e) inclusion only of passenger cars with engine displacement of 2,000 cc. or less; and (f) the sale of participant cars only at BOI-approved prices.

But even with the revised guidelines, some of the participants continued to suffer losses and the industry as a whole continued to perform poorly. The viability of the car manufacturers became particularly problematic during the recession years which started in 1981; it collapsed during the economic contraction that followed the Aquino assassination in 1983.

Ford Philippines ceased its operations in August 1984 due to financial losses amounting to ₱600 million; it sold its stamping plant to China. GM Philippines, which could not find enough market for its 72,000 transmissions, cut its labor force by 50 percent and eventually also pulled out of the Philippines. Delta Motors, which was the exclusive distributor of Japan's Toyota Corporation, also suffered financial difficulties and was foreclosed by the government-owned Philippine National Bank to which it owed one billion pesos.

Car Development Program

By 1986 the Philippine car industry was in its third year of low and declining production and sales volume. (The downtrend in fact continued until 1987.) It was felt that something had to be done to save the car industry.

On December 1987 President Aquino issued Memorandum Order No. 136, abolishing the PCMP and adopting in its place the CDP.

The objectives of CDP are essentially similar to those of its predecessor: the development of a local parts manufacturing industry; technology transfer and development; employment generation; and foreign exchange savings/earnings. There is, however, a greater emphasis on technology transfer and the development of a local car parts industry under CDP. Going by the nomenclature, the manufacture of the whole car seems to be de-emphasized under the CDP.

As in the PCMP, the number of participants under the CDP is also limited, to three firms, namely, Pilipinas Nissan, Toyota Motors Philippines, and Philippine Automotive Manufacturing Corporation (PAMCOR). The three firms were chosen on the basis of their performance in the immediately preceding years. Each participant is allowed to manufacture only two basic car models.

Passenger car sales expanded rapidly from 1988 to 1990 with the revival and growth of the Philippine economy. With increased demand and cost of production, however, car prices also rapidly climbed.

In response to these developments, particularly to the increasing unaffordability of passenger cars, a supplementary guideline to the CDP, Memorandum No. 286, was issued in March 1990. This memorandum provided incentives for the development of a low-priced passenger car called "people's car", in order, as the guideline states, "to respond to the need for passenger cars with affordable prices".

Under the "people's car" program, participation is opened to other car manufacturers, although BOI reserves the right to limit their number according to certain criteria. One of the criteria is that the "people's car" must carry a price tag of around ₱175,000. The price ceiling is, however, subject to revision in case of changes in wage, tax and exchange rates.

While they are still in the process of setting up their manufacturing facilities, participants in the "people's car" program are allowed to bring in cars in semi-knocked down (SKD) form for a period of six months, subject to extension for another six months.

INDUSTRY STRUCTURE

The Stakeholders

There are basically four groups interested in developments in the car manufacturing industry: the car buyers/consumers, the car manufacturers, the car distributors, and the government. Each group has its own interest(s) which may or may not coincide with those of the other groups.

The car-buying public's interest is in being able to buy cars at affordable prices, regardless of whether these cars are CBUs or CKDs.

Car importers and manufacturers, or importers and distributors of CBUs and assemblers of CKDs, respectively, are both interested in maximizing their profits from their respective operations, but differ as to the direction of the policies that they espouse. Importers of CBUs naturally want low duties and unrestricted importation of CBUs. (The importation of CBUs is, however, presently not allowed.)

Car assemblers, on the other hand, want high tariffs on CBUs, low tariffs on CKDs as well as on car parts and components. (Local car parts manufacturers, for their part, want high duties on imported parts and low tax rates on locally-produced parts.)

The government wants the revenue that can be derived from tariff and duties on imported cars and their various parts and accessories; at the same time, however, it has to balance this against other objectives such as, for instance, creating employment and providing training in the motor vehicle manufacturing as well as in the forward and backward-linked industries, both of which argue for lower tariffs and other taxes and duties on the industry.

The Major Assemblers

The domestic car industry is a highly concentrated industry with a few government selected auto firms dominating the market. Earlier, under the PCMP, there were only five participants allowed. Below is a profile, of the "Favored Five" under PCMP and of the "Big Three" under CDP.

The "Favored Five" under PCMP

- General Motors (GM) Philippines, Inc.

  GM Philippines was organized in 1972 as a joint venture between GM Corporation USA and two local partners, Yutivo Corporation and Francisco Motors Corporation, which already had some experience distributing and assembling vehicles. GM initially owned 60 percent of the equity while Yutivo and Francisco Motors owned 30 percent and 10 percent respectively.

  Towards the end of 1976, however, GM Philippines became a wholly-owned subsidiary. For its participation in the PCMP, GM Philippines submitted a proposal to set up two operations, namely, vehicle assembly and manufacture of transmission. For the latter, it organized the GM Philippines Manufacturing Corporation which had an estimated production capacity of 72,000 transmissions a year.

- Chrysler Philippines Corporation

Chrysler Philippines Corporation was incorporated in 1963 with the following principal investors: Chrysler Corporation S.A., C.J. Yulo and Sons, Nissho-Iwai Co., Ltd., and Mitsubishi Motors Corporation. The tieup with the two Japanese firms was encouraged by the government specifically for the production of small cars. For its participation in the PCMP, Chrysler Corporation, in addition to assembling cars, organized the Asian Transmission Corporation for the production of transmission assemblies.

Chrysler Philippines Corporation later became Canlubang Automotive Resources Corporation (CARCO).

- Delta Motors Corporation (DMC)

Delta Motors Corporation was organized in 1961 by a group led by Ricardo Silverio. Starting with the assembly of passenger cars, Delta diversified into basic utility vehicles, commercial and industrial vehicles, and military vehicles. It also went into the manufacture of package and unit air-conditioning as well as car air-conditioning, television, refrigerators and stereophonic equipment. In 1977 Delta entered into an agreement with MAN, a German firm, to assemble and distribute buses and commercial vehicles. Delta assembled and distributed Toyota cars.

Delta grew phenomenally during the 1970s, in part because of the alleged close ties of Silverio to President Marcos. But, as stated earlier, this did not prevent PNB from foreclosing Delta when the latter defaulted in its huge obligations.

- DMG, Inc.

DMG was incorporated in 1955 as D.M. Guevarra Co., Inc. for the sole purpose of assembling and distributing automotive parts and components. In 1958 DMG went into car manufacture, assembling and selling the German car Volkswagen. In 1967 it produced the *Sakbayan*, the first Filipino all-purpose vehicle.

DMG was the only wholly Filipino-owned and managed participant of the PCMP. DMG, however, later tied up with Nissan.

- Ford Philippines, Inc.

Ford Philippines, a Philippine affiliate of the Ford Motor Co. of Michigan, began its assembly operations in the Philippines in 1966. In 1972 it started manufacturing the Ford Fiera, a utility vehicle. In that same year Ford built its stamping plant in the Export Processing Zone in Mariveles, Bataan. The plant produced and supplied car body stampings to Ford affiliates in Australia, Germany, Singapore and Taiwan.

Ford was forced to discontinue its operations in the Philippines during the first half of the 1980s due to its failure to comply with the local content requirement and unprofitable operations.

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Table 6.4 shows the respective shares of the major assemblers in 1971 (before PCMP) and 1978 (when PCMP had been underway for five years). Toyota clearly had a commanding lead with 40 percent of the market. But what is also obvious from the table is that the five PCMP participants had bigger market shares than those outside the Program (Renault, Universal Motors, others).

Table 6.4
Market Share of Program Participants, 1971 vs 1978
(in percent)

Company	Owner/Partner	1971	1978
Delta	Toyota	23.1	40.8
CARCo	Mitsubishi	11.4	26.3
Ford	Ford	20.9	13.3
DMG	Volkswagen	21.7	11.6
GM	GM	15.2	6.8
Universal*	Mercedes/Nissan	3.2	1.1
Renault*	Renault	3.4	0.1
Others	NA	1.1	0

Source: Insight, August 1979.

With the abolition of the PCMP, only three participants are allowed under CDP: Toyota Motors Philippines, Nissan Motors, and PAMCOR.

The "Big Three" under CDP

- Toyota Motors Philippines

Toyota withdrew when Delta Motors was in financial trouble in the mid-eighties. It resumed its operations in the Philippines in 1988, banking on the surge of economic growth. Toyota has an investment of ₱4 billion in plant and equipment, and operates the most modern assembly plant among the three CDP participants. It is putting up its own transmission plant.

Toyota Motors Philippines' ownership structure is as follows: Metrobank, 60 percent; Toyota Japan, 25 percent; and Mitsui, 15 percent. Despite substantial Philippine ownership, top management of Toyota is at present Japanese.

Toyota assembles the Corolla, Corona and Crown brands which are very popular in the Philippines. Toyota held almost 47 percent of the domestic car market in 1991, up from 43 percent the year before.

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- Nissan Motors, Inc.

Formerly Pilipinas Nissan, Inc., it was formed in April 1982, taking over the license of DMG. Seventy (70) percent of Nissan's shares is owned by Philippine nationals (the original incorporators/stockholders are Jose Sandejas, Vicente Mills, Leonardo Gamboa, Rex Drilon and Edilberto Narciso, Jr.), the rest, or 30 percent, by Japanese nationals (presumably the Nissan Corporation of Japan).

Nissan has investments in plant and equipment of around half a billion pesos in its Quezon City assembly plant. It also has investments in Asian Transmission Corporation, which has an annual rated capacity of around 30,000 units. Nissan also plans to expand its capacity by investing in a ₱1.3 billion-plant in Sta. Rosa, Laguna. Such expansion will increase Nissan's capacity from the present 700 units/month (based on an 8-hour shift) to 2,000 units/month. Nissan is also exploring the possibility of a tieup with Universal Motors Corporation to increase its dealership network.
Nissan assembles the Cefiro, Bluebird, California and Sentra brands. It had almost 25 percent of the car market in 1991, up from only 20 percent in 1990.

- PAMCOR

As mentioned earlier, PAMCOR, is the latest reincarnation of Chrysler Corporation, which earlier teamed up with the Yulo group to form CARCO. PAMCOR is now 100 percent owned by Mitsubishi Corporation of Japan.

PAMCOR has investments in Asian Transmission Corporation. It also has tieups with the Union Motor Corporation and Citimotors, Inc.. Two financial institutions, Rizal Commercial Banking Corporation and BA Finance Corporation have stakes in the firm.

PAMCOR's product lines include the Galant and Lancer brands. PAMCOR held 28.5 percent of the domestic car market in 1991, slipping from 37 percent in 1990.

In terms of market shares, Toyota, with more than 40 percent of the market, has successfully maintained, even increased, its share compared to the 1970s. PAMCOR, after attaining a market share of 37 percent, is back to its percentage share in 1978.

New Entrants

The market shares of CDP participants, however, are now under threat from participants in the "people's car" program (Columbian Autocar Corp., Honda Cars Philippines Inc., Asian Carmakers Corp., Italcar Philippines Inc.).

These new entrants into the car industry are allowed to import SKDs, a privilege which enables them to create market awareness immediately. Moreover, to the extent that the prices of some of their cars overlap those of the CKD participants, they too compete with the latter in a very limited market. [1] It is therefore not surprising that the entry of the "people's car" was strenuously opposed by spokesmen of the three original CDP participants. To protect their market, PAMCOR and Nissan have also entered the people's car category. None of the new entrants appeared to have passed this test.

Given the limited size of the market, it is doubtful whether some of these small carmakers would have found their entry viable without the SKD import privilege. Considering the unfilled demand in this segment, the lucky participant by mere inclusion could immediately reap rents from importations. The test of the new entrants' competitiveness is their compliance with the rule to shift to assembly of CKDs after the 16-month grace period.

The BOI is also pursuing the creation of a luxury car category under the CDP. The BOI believes there is a niche for luxury cars in the domestic market that regular assemblers are not filling up. The CDP participants, however, are strongly opposing this move as it would supposedly impede the current industry rationalization program.

Industry Associations

Participants in the PCMP and later in the CDP have, upon the prodding of Senator (then BOI Chairman) Paterno who wanted the industry to have only one voice, organized themselves into the Automotive Manufacturers Institute, Inc., or AMII; together with other manufacturers of cars, parts and accessories have formed the Philippine Automotive Federation, Inc. (PAFI).

The present president of PAFI, Henry Moran, has argued strongly for the development of the local motor vehicle industry (Moran, 1991b). Moran justifies the PCMP in terms of its accomplishments (foreign exchange earnings/savings, employment, etc.). He defends the industry against the charge that car prices are too high in the Philippines and bats for continued and increased government support for the program. Moran, however, concedes that the future of the Philippine automotive industry lies not in the assembly or manufacture of complete cars but in the manufacture, primarily for export, of car parts and components.

Car distributors (both of CKDs and CBUs) also have their own organizations intended to protect and promote their particular positions. One of the most articulate spokesmen of the car distributors before and during the early years of PCMP was the late David Sycip, then chairman and past president of the Philippine Automotive Association, an association of motor vehicle dealers, and president of Northern Motors, a car distributor. When the idea of a progressive car manufacturing program was first being proposed, Sycip, in a letter to the BOI, cautioned that the country was not prepared to embark on a car manufacturing program.

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[1] One Honda model which is entered under the "people's car" category, the Civic sedan, reportedly carries a price tag of over half a million pesos, which is higher than the price of some of the lower-end models of the CDP participants.

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Market Demand and Supply

Tables 6.5 and 6.6 show the demand and car sales per participant since the start of the PCMP program. Before the PCMP, the annual demand for cars, both locally assembled and CBUs, was around 20,000 units. The industry attained its peak in 1978 and 1979 with annual car sales of more than 35,000 units; on the other hand, the lowest point in the industry was during the period 1984-87, when annual sales averaged around 5,000 units,

Table 6.5
Historical Demand for Cars, 1977- 1990

Year	Total Demand	Assembled Car	Imported CBUs
1977	45,422	32,269	13,153
1978	45,390	35,308	10,082
1979	47,689	35,029	12,660
1980	48,834	26,227	22,607
1981	35,645	26,070	9,575
1982	33,292	26,858	6,434
1983	31,111	27,349	3,762
1984	12,722	6,355	6,367
1985	8,589	4,769	3,820
1986	7,571	3,640	3,931
1987	10,657	5,543	5,114
1988	16,322	11,038	5,284
1989	32,808	28,206	4,602
1990	42,389	34,055	8,334

Source: Automotive Manufacturers Institute, Inc. (AMII)

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Table 6.6
Car Sales per Participant, 1973 to 1991

YEAR	FPI	GMP	DM\G	DMC	CARCO/ PAMCOR	PNI	TMP	TOTAL
1973	2,607	2,185	2,624	6,021	3,299			16,736
1974	4,657	2,002	3,180	6,487	5,519			21,845
1975	4,281	2,026	6,807	7,641	6,732			27,487
1976	4,019	3,403	7,641	10,569	8,479			31,319
1977	4,051	2,347	10,569	13,354	9,364			32,269
1978	4,874	2,399	13,354	13,779	10,242			35,308
1979	2,895	2,380	14,040	14,040	11,076			35,029
1980	1,965	2,435	12,634	12,634	9,193			26,227
1981	5,144	2,573	8,980	8,980	9,373			26,070
1982	5,491	2,254	9,537	9,537	9,576			26,858
1983	7,253	2,804	8,219	8,219	8,618	455		27,349
1984	2,391	1,090	215	215	2,124	535		6,355
1985		921			2,716	1,132		4,769
1986		37			2,549	1,054		3,640
1987					3,291	2,252		5,543
1988					5,429	5,609		11,038
1989					10,645	9,368	8,193	28,206
1990					8,996	8,039	17,020	34,055
1991 (May)					2,470	1,300	3,711	7,481
TOTAL	49,628	2,8856	29,265	111,476	129,691	29,744	28,924	407,584

Legend: FPI is Ford Philippines, Inc.; TMP is Toyota Motors Philippines;
PNI is Pilipinas Nissan Inc.; GMP is General Motors Philippines
Source: AMII

The annual rated capacity of the three CDP participants aggregates 24,000 units; Toyota, 10,000 units; PAMCOR, 6,000 units; and Pilipinas Nissan, 8,000 units. With three shifts, the industry's maximum production capacity is placed at 75,000-80,000 units annually. With total car sales peaking at 34,055 units in 1990, this means that roughly 40 percent of capacity is being utilized, a figure more or less consistent with capacity utilization under PCMP. By most accounts, these figures are far below the production capacities and sales needed to attain scale economies. (By contrast, for example, Thailand and Malaysia already produce more than 100,000 units annually.)

Even with only one assembler, the level of domestic demand (35,000 maximum) still would not enable one producer to realize scale economies. No production figures showing exactly at what volume economies of scale are realized are, however, available. The implications of this will be pursued in a later section.

Tariffs on Passenger Cars

The government has sought to protect domestic car manufacturing through a combination of taxes and tariffs. Tariff on cars and parts increased during the 1970s, then decreased during the 1980s, decreasing further under the tariff reform of 1991 (See attached Annex 1 for tariffs and taxes on CBUs, CKDs and car parts and components.)

The result of this protection has been to increase the price of locally assembled cars to levels higher than those of cars sold abroad, to around 1.8 times in the case of some models. although there are problems in comparing models across countries (the same exact car model is not sold in two countries), a rough indication of the price difference may nevertheless be seen in the following comparison of a Nissan 1.6 cc. sold in the Philippines and in California:

Nissan 1.6 M/T (Philippines)	₱465,000.00
Nissan Sentra (California)	214,058.00*

* Based on price of $8,233 and converted at the rate of ₱26 to $1.

Even if transport cost estimated to be around ₱40,000 (from Japan) is added, the resulting price, without tariff and duties, of a Nissan Sentra from California would be around 50% lower than the locally-assembled counterpart. This is of course just a single case, but we suspect that the pattern is similar for other brands and models.

GENERAL ASSESSMENT

Emergence of Entry Barriers

Since the early 1970s when the government launched its Progressive Car Manufacturing Program (PCMP), the local car manufacture and assembly sector has been a highly regulated as well as heavily protected industry. It is a government-promoted oligopoly, with the number of participants deliberately limited to a few.

Potential entrants to the industry come from: (a) importers of completely built units (CBUs) and (b) new car manufacturers who wish to join the government car program. The players include car parts manufacturers who stand to gain from the development of car manufacturing, and metals and engineering industries which are forward-linked to car assembly.

For CBU importers, the major barrier to entry is the high tariff relative to those applicable to completely knocked down units (CKDs). Under the New Tariff Code, these are projected to remain at 50 percent for the 1991-1995 period, compared to 20 percent tariff for CKDs. High tariffs and other duties on top of already high imported cost (exclusive of duties) of CBUs place them beyond the reach of most Filipinos.

Huge capital investments primarily in the form of plant and equipment also pose a barrier for most entrants. Car manufacturing is a highly mechanized and capital-intensive process. According to industry sources, an investment of at least half a billion pesos is required for fixed assets (plant and equipment).

The most effective barrier to entry has been the government policy towards the industry itself. Since the BOI embarked on the PCMP, and later the CDP, the story of the car industry has been one of continuing government attempts to reduce the number of participants -- from five under PCMP, to three under CDP. For the participants, the government provides a number of incentives: foreign exchange allocation (under PCMP), lower tariffs on CKDs and on parts and components, and access to credit.

The reason for government intervention is the perceived importance of car manufacturing in terms of its linkages with the metal and engineering industries. (Other reasons are foreign exchange earnings/savings; employment generation, especially in the manufacture of car parts and components; and technology transfer). The purpose for limiting the number of participants has been to enable the industry to realize economies of scale.

With a narrow domestic market for cars (around 30,000 to 35,000 units), the presence of many participants contributes to the high costs and hence high prices of locally assembled cars and the unprofitable operation of car manufacturers. The limit on the number of participants has not spared some firms from losses (e.g., Ford and GM). On the other hand, nonparticipants, e.g., Francisco Motors, have consistently posted profits.

Even now, however, there is no clear prospect that the scale economies cited as justification for government-sponsored barrier to entry will be achieved. The evidence for the alleged presence of economies of scale has invariably been the experience of other major car-producing countries: primarily Japan and the US, which produce millions of cars a year and between themselves account for more than 50 percent of the world's output of cars. What is at issue, however, is not whether car-making in the abstract permits scale economies but whether the size of the domestic car market in the foreseeable future will be sufficiently large to permit the alleged scale economies to be reaped. This is based on the assessment that there is only a small likelihood that the country will expand strongly into exports of automobiles in the near future.

The recent opening up of the market to even more manufacturing entrants (in the "people's car" category and, as proposed, in the "luxury car" category) makes the achievement of such economies even more unlikely. The likely effect of this misplaced response is to drive up costs for all participants, as well as, prices for consumers. One should note that even Malaysia's vain experiment in car manufacturing accommodated only a single firm.

Impact on the Economy

The negative effects of entry barriers are evident. Car buyers pay more than double the border prices for locally assembled cars. Only the very wealthy can afford to pay the prohibitive taxes imposed on imported cars, and, until the entry of people's car manufacturers, can buy even the local cars. No wonder, there is great incentive for importers to technically smuggle disassembled cars (known as "chop-chop" cars).

Sheltered by high tariff walls, CDP participants have every reason to be complacent. Yet they produce too little at too high a cost. For a time, buyers had to pay reservation fees, (deductible against the price), of as high as ₱50,000 to have their orders filled (there are even color fees of roughly ₱30,000 for the buyer to get the right colors).

Meanwhile, the government appears to have lost sight of the car programs concept and direction. If the purpose is indeed to develop an integrated car industry basing itself on the domestic market, then the number of firms is evidently too large. If the purpose is to manufacture not automobiles but components for exports, then entry barriers are unnecessary and there is no point restricting the number of firms. Finally, if the argument is that production externalities and linkages, these have not been demonstrated, and it is doubtful whether cars, and not trucks or utility vehicles, are a less costly way of achieving the same ends.

Policy Directions

The foregoing suggests the need to recognize the failure of the CDP or at least to reassess its rationale. After all, industry sources already concede that the future of the Philippine automotive industry lies in the manufacture, primarily for export, of car parts and components. If this is the expected and desired direction for local firms, then policy-induced entry barriers are pointless and must be eliminated.

We propose to open the domestic market to competition and let market forces operate more freely. The proposal to open a "luxury car" category is mere tinkering. What the government should do is announce the phaseout of incentives for car manufacturing within two years; imports of CBUs should be freely allowed, but higher domestic taxes on locally assembled and imported units should be imposed for environmental reasons. At the same time, fiscal incentives may continue only for R&D-related activities in the car industry, whether these are undertaken by assemblers of foreign or domestic brands or smaller parts manufacturers. This should have the salutary effects of encouraging innovation and forcing existing as well as potential car manufacturers to produce more efficiently than they do at present.

Under this scenario, the players themselves should exploit opportunities without being propped up by government privileges such as SKD imports. Some potential entrants will no doubt find the domestic market marginal and hesitate to enter it. Others, however, may see the situation from a different perspective and be able to create their niches. In a free play of market forces without privileges, inefficient, uncompetitive players will simply wither away while the more efficient ones will remain without significant loss to government resources.

Research Areas

Since it is proposed here to phase out incentives to the car industry and open it to competition, including CBU imports, one of the areas that need to be studied is the fiscal and employment implications of such market liberalization. The timing of such liberalization should also be studied with the end in view of preventing or minimizing dislocation or disruption in the domestic car industry.

Although the Philippines was among the first in the region to come up with a car manufacturing program, it has fallen behind its neighbors in the development of a local car industry. Perhaps a study of our more successful neighbors, with the end in view of learning from their experiences in car manufacturing, can be included in the research agenda.

Tariff Structure of Assembled and Unassembled Passenger Vehicle

Legal Basis Rate	Year	Description	
RA 1937	1957	A. xxx xxx	
		B. Passenger vehicle other than buses:	
		1. Diesel or semi-diesel:	
		(a) Unassembled........................	ad val 20%
		(b) Assembled........................	ad val 35%
		2. Other:	
		(a) Unassembled:	
		(1) With not more than four cylinders..................	ad val 25%
		(2) With six cylinders..................	ad val 60%
		(3) With more than six cylinders..................	ad val 100%
		(b) Assembled:	
		(1) With not more than four cylinders..................	ad val 40%
		(2) With six cylinders..................	ad val 80%
		(3) With more than six cylinders..................	ad val 160%
		C. Sports cars........................	ad val 250%
		D. Other	
		1. Diesel or semi-diesel........................	ad val 15%
		2. Other	ad val 25%
		Motor vehicle chassis fitted with engines:	
		A. Diesel or semi-diesel........................	ad val 15%
		B. Other........................	ad val 25%

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PD 341977A. Trucks and Buses......xxx			
		B. Motor cars, jeeps and vans, unassembled:	
		1. With not more than four cylinders......	ad val 30%
		2. With six cylinders......	ad val 70%
		3. With eight cylinders and above......	ad val 100%
		C. Motor cars, jeeps and vans, assembled......	ad val 100%
		D. Components, parts and/or accessories imported from one or more countries for assembly of passenger cars by participants in the progressive car manufacturing program upon prior authorization and certification of the Board of Investments......	ad val 30%
PD 1464	1980	A. Trucks and buses......	xxx
		B. Motor cars, jeeps and vans, unassembled:	
		1. With not more than four cylinders......	ad val 30%
		2. With six cylinders......	ad val 70%
		3. With eight cylinders and above......	ad val 100%
		C. Motor cars, jeeps and vans, assembled......	ad val 100%
Tariff and Customs Code	1982	Motor vehicles for the transport of persons, goods and or materials (including sports motor vehicles.	
		A. Passenger motor cars (other than public service type vehicles), including vehicles designed for the transport of both passengers and goods:	
		Components, parts and/or accessories imported from one or more countries for assembly of passenger cars by participants in the progressive car manufacturing program upon prior authorization and certification of the Board of Investments......	ad val 30%
		(effective 1981 to 1985)	
Tariff and Customs Code	1991	Components, parts and/or accessories imported from one or more countries for assembly of passenger cars by participants in the progressive car manufacturing program upon prior authorization and certification of the Board of Investments:	
		1. Asian utility vehicles and light commercial vehicles......	20%
		2. Passenger cars......	30%
		3. Other......	50%
		Motor cars and other motor vehicles principally designed for the transport of persons including station wagon and racing cars......	50%

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