Capacity Building for SMEs and Competition Policy: Baseline Study and Regulatory Impact Assessment

April 2017
Executive Summary

Policymakers have increasingly focused on small and medium enterprises (SMEs) as an engine of sustainable economic growth. Across the 21 Asia-Pacific Economic Cooperation (APEC) member economies, SMEs account for over 97 percent of all enterprises, employ over half the workforce, account for between 20-50% to GDP and drive up to 35% of the value of total exports. However, SMEs cannot succeed when they do not have equal and fair chance of competition with larger and more established foreign and domestic rivals. The adequate provision of competition policy and law is important in promoting opportunities for SMEs to grow.

This report is part of the broader APEC sponsored project titled *Capacity Building for SMEs on Competition Policy and Law*. The aim of the project is to build the capacity of SMEs in relation to competition policy with a particular focus on The Philippines. The purpose of this report is to identify key issues facing SMEs in relation to competition policy at the APEC level with specific reference to The Philippines. The findings will guide fieldwork and future engagements with the key stakeholders in The Philippines.

The report is built upon a review of related literature on relevant SME and competition policy and law, particularly as it pertains to APEC and The Philippines. It draws on a broad cross-section of economic data and statistics to help understand the significance of competition policy and law in relation to its impact on SMEs.

The findings and next steps proposed in this report are presented in two parts: first, as relevant to APEC and, second, as relevant to The Philippines and the work of the Philippine Competition Commission (PCC).

APEC

Changes in APEC member economies’ competition policy and law have the potential of increasing output significantly. The state of SMEs within APEC is diverse. In many higher-income economies, SMEs account for a relatively large share of firms and employment. In middle and lower income economies, SMEs tend to account for a lower share of total firms and contribute fewer employment opportunities. This diversity was revealed across a number of indicators relating to domestic and foreign competition, competition policy and effectiveness, and trade barriers.

Key findings

*Policies that affect SME development and competitiveness*

Policymakers increasingly see competition policy and law as key to affecting SME performance in the APEC region. Across the APEC member economies, numerous policies affect SMEs’ ability to compete domestically and internationally. This includes support services, technology transfer, entrepreneurial education and among others. One of the most important policies affecting SMEs competitiveness is business regulation. Despite evidence of negative outcomes of excessive regulation, many APEC member economies still over-regulate businesses with the data revealing that more competitive economies tend to have less, or better, regulation.
Export policy was also identified as directly influencing domestic and foreign competition in APEC member economies, particularly the impediment arising from high export costs. In addition to tax policy, financial and banking policy represented important areas in determining the extent of SME competition; regulations that disadvantage SMEs from obtaining finance may distort competition away from the SME sector.

While some authors contend SMEs face challenges requiring special attention related to competition policy and law, this is not supported by broader evidence. Rather, competition policy or enforcement practices should focus on leveling the playing field conducive for SMEs to thrive.

**Current competition policy and law**
APEC work on controlling and stabilizing the outcomes of anti-competitive behaviour can help facilitate learning among economies with different levels of experience.

Variation in banking sector market power presents particular concerns for SMEs such as where the financial sector market power raises SMEs’ cost of capital. Competition policy which helps lower these mark-ups could potentially lead to significant increases in credit as a proportion of GDP. Credit could expand significantly for some APEC member economies if competition in banking services improve across the region.

There is great variability in competition policy and law structures within APEC member economies. This has flow on effects to the competition performance in each economy. APEC can support peer review of competition policy and law conducted by the international community by building political support and sharing specific information about competition related regulation.

**International cooperation in enforcement**
International cooperation increasingly promotes convergence among APEC member economies’ competition policy and law. Informal mechanisms such as peer review have served as more effective in promoting competition policy and law reform than international treaties. Any APEC work on competition policy and law would need to identify the obstacles which undermined previous attempts at multilateral cooperation on competition policy and law, and spur member action on their own.

**Options for international reform**
A broad range of proposals have been put forward for competition policy and law reform. Key among these are requirements to engage in strategic planning, prioritisation of sectors to study and enforce, conduct of ex-hoc and post-hoc evaluation, and better information dissemination and communication.

The data show significant differences between high and low performing competition authorities. Differing competition policies and laws explain part of these differences as many competition authorities, or the law that governs them, still exempt some sectors from competition provisions. Smoothing out differences between lagging and leading competition authorities is likely to require international action coordinated by an organisation such as APEC.
**Promoting a culture of competition among SMEs**

Competition policy and law only gain prominence with strengthening of a jurisdiction’s culture of competition. Promoting the effectiveness of competition policy and law in an economy is more important than drafting or administration prowess. This suggests that one means of increasing the effectiveness of competition policy and law lies in improving the awareness of SMEs to market competition.

Competition authorities typically react to macroeconomic factors, where competition is either promoted or restrained and, as a result, harm SMEs’ ability to rely on stable competition policy and law. Policy instability represents one of the clearest impediments to promoting competition in the APEC region. Competition authorities may also fail to adequately address the barriers that limit SMEs compete. Such a situation is not conducive to promoting a culture of competition.

**Encourage independent competition authorities**

Establishing the independence of competition agencies represents an easy method of improving their performance and harmonisation across the APEC region. Such independence does not need to be unconditional. Within their mandate, there may be provisions for the ministry overseeing competition issues to assert influence under specific predefined circumstances. These provisions need not remove competencies from sector regulators from overseeing competition within their mandate.

**Confidentiality, transparency and accountability**

Competition authorities need to exchange confidential information during the investigation of cross-border antitrust cases and competition authorities in countries with similar legal and economic systems. However, there is great diversity among the APEC member economies. While APEC and its member economies can extend existing agreements by making more information sharing mandatory, this could be difficult in practice.

**APEC Secretariat work on competition on “public goods” provision**

APEC work on competition issues has the potential to save member economies significant resources in studying and adapting to other countries’ policies. APEC could consider investing resources to better coordinate and publish competition policy and law activities among its members in a timely manner. Benchmarking particular provisions in various APEC member economies’ competition policy and law could help facilitate the peer review process.

**Next Steps**

While there are constraints on the reach and influence of APEC as an international institution, there are a number of opportunities for the APEC Secretariat to support and guide the work of its member economies to enhance competition policy and the performance of SMEs in the region.

1. **Facilitate member economies’ engagement in peer review related to competition policy and law, particularly as it pertains to SMEs.** Promoting the sharing of learning and best practice between member economies could bring strong benefits.
2. Assess the feasibility of hosting a centralised database related to competition measures accessible to APEC member economies. This would include ensuring information are updated regularly and could serve as a conduit for SME studies, information and other resources for SMEs.

3. Promote greater dialogue on cross-jurisdictional cooperation in relation to competition policy and SMEs. As working across borders becomes the norm, APEC could ease the transition for many member economies through guidance on how extra-territorial application affect these countries as well as facilitating the transfer of information and evidence.

The Philippines

In the Philippines, the number of SMEs by far outnumber larger companies. Of the approximately 947,000 business registered in 2014, 943,000 are SMEs. This shows the importance of SMEs in The Philippines’ broader competitive environment. However, lack of growth of these SMEs highlights the obstacles they face. From 2000 to 2010, SME numbers hovered at around 800,000 and only in 2012 did the number increase to their present number. The composition of SMEs in terms of the size, the sectors they serve and their value-added has also remained stable in recent times.

Since the early 1990s, The Philippines has adopted SME friendly legislation. This includes establishing a number of government institutions with the mandate to review, monitor, evaluate and otherwise comment on SME development policies and institutions, as well as assisting with administrative tasks and implementing decisions.

The 2015 Philippine Competition Act serves as a significant piece of legislation related to anti-trust and competition law. The newly established PCC issued its implementing regulations and first regulations on 3 June 3 2016 for application one month later. The Act’s guiding principles correspond with modern competition law and its insistence on promoting consumer welfare, breaking up anticompetitive combinations and prohibiting the abuse of market power.

Key Findings

SMEs in the Philippines compared to APEC

The SME sector of the Philippines remains underdeveloped by APEC region standards. This was in terms of both the number of enterprises and level of employment as compared to other APEC member economies. While in absolute terms it continues to lag behind other jurisdictions, in the period 2011-2015, it was noticeable that competition grew in the Philippines at a faster rate than in economies such as Indonesia and Viet Nam. During this period, policymakers achieved moderate improvement in increasing foreign and domestic competition performance, while achieving strengthened anti-monopoly law, and reduced trade barriers.

Policies that affect SME development and competitiveness

Policies designed to help SMEs in the Philippines have had varying levels of success. There have been a number of initiatives that produced positive results such as the establishment of the Small Business Guarantee and Finance Corporation to provide finance, information, training and marketing services to local SMEs. However, the results of other initiatives have been mixed. For example, the impact of Micro, Small, and Medium Enterprise Development Plan has been largely
neutral reflecting that it only tangentially influences improvements in the competitiveness of local SMEs. Similarly, an initiative to encourage financial institutions to loan funds to SMEs has not achieved the expected outcomes.

A critical issue for the Philippines relates to distortions arising from business regulation and poor enforcement. The report highlighted that the Philippines, along with Indonesia, ranks the worst in the APEC for business regulation and level of competition. Rectifying such distortions will be critical prior to the full implementation of competition policy and law. The report identified that a shift towards pro-competition tax policy in the Philippines will likely be supportive of efforts to improve market competition.

**SME Development in The Philippines**

A broad assessment of the Philippines’ SME market points to constraints to market competition. The largest concentration of SME centres on trade, hospitality, manufacturing and other services. Many of the companies in these sectors represent lower tech, lower skilled firms without competitive advantage. These sectors tend to suffer the most in an environment with vigorous competition. Policies which promote competition without simultaneously encouraging innovation could result in large scale disruptions in wholesale and retail markets, hospitality, and manufacturing.

The way that SMEs in the Philippines tap possible resources from formal financial institutions provides clues on the extent of how competition law and policy could improve SME competitiveness. Despite penalties levied against financial institutions for not giving 8% of their capital as loans to SMEs, between 2001 to 2012, of the 19 universal banks, 14 failed to lend the minimum amounts to micro and small enterprises, and 13 failed to lend to medium-sized enterprises. High taxes and administrative burdens also inhibit Filipino SMEs’ incentives to compete and expand.

**Next Steps**

The PCC is still a young institution and time will be required for it to mature and establish credibility. There are a number of activities that the PCC could consider.

- Address issues arising from sectors with only a few owners.
- Promote a shift towards pro-competition tax policy in The Philippines.
- Rectify distortions arising from copious business regulation and poor enforcement.

More broadly, the PCC may wish to the following recommended activities.

1. **Focus on establishing a strong track record and reputation for success.** Most competition commissions or agencies require decades to reach their full effectiveness, including establishing a record for fairness and effectiveness.

2. **Focus on priority areas.** While it is important to understand the competition environment at a holistic level, if the PCC plans too many activities at the start, there is the risk of resources and capabilities being spread too thin.
3. Engage with SMEs, including consideration of training and awareness raising activities, related to their legal obligations and rights. In general, SMEs are likely in need of greater support in understanding their legal obligations and rights than large companies which can afford to hire compliance and legal staff. The PCC’s role could include the provision of training and relevant materials to support SMEs.

4. Work with business associations and representative groups to engage SMEs in the advocacy, awareness raising and engagement activities alluded to in Point 3 above. The PCC can cooperate with business associations and trade groups to educate large numbers of SME managers. Experience across APEC has highlighted that this is an effective way for competition agencies to disseminate information to SMEs.

5. Ensure the relevant staff within the PCC are equipped with adequate skills and capabilities to undertake their work. PCC staff should be adequately supported so that they are able to detect anticompetitive practices involving or harming SMEs, investigate these practices, and recommend remedies as needed.

6. Ensure the relevant staff within the judiciary are equipped with adequate skills and capabilities to undertake their work. Judges need to be well positioned to adjudicate competition related cases and related appeals. As in many jurisdictions, Philippine judges may be tasked with adjudicating competition related cases where they have little experience. Assistance from the APEC region could be sought to provide the required support.

7. The PCC should work with APEC in sharing their experience with other member economies. At a basic level, this should include the recording of lessons learned and evaluation of key policies and activities. It could also include the commissioning of studies to identify lessons applicable to the larger competition community, where the internal PCC staff do not have the skills or resources to complete the work.
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1. Introduction

Policymakers around the world have increasingly focused on small and medium enterprises (SMEs) as an engine of sustainable economic growth. Within the 21 Asia-Pacific Economic Cooperation (APEC) member economies, SMEs account for over 97 percent of all enterprises, employ over half the workforce, account for between 20 and 50% to GDP and drive up to 35% of the value of total exports.¹ The significance of SMEs is reflected by their increased investment in new technologies and business processes. However, they can only succeed when they have equal and fair chance of competition with larger and more established foreign and domestic rivals. The adequate provision of a policy environment conducive to market competition is important in promoting opportunities for SMEs to grow, access international markets, and contribute to sustainable economic growth.

Purpose and approach

This report forms part of a project aimed at building the capacity of SMEs in relation to competition policy and law. The project is supported by APEC and implemented in consultation with the Philippine Competition Commission (PCC). The contribution of this report is in the identification of key issues facing SMEs in relation to competition policy and law at the APEC level and with specific reference to the Philippines. While this report can guide future engagements with the key stakeholders of PCC, it is also a stand-alone, distinct piece of analytical work.

This report is based on a review of related literature on SME and competition policy and law that pertain to APEC and the Philippines. It draws on a broad cross-section of economic data and statistics to help understand the significance of competition policy and law in relation to its impact on SMEs across the APEC region. Reflecting the scope of the report outlined above, it is not a comprehensive assessment of all literature in this field. Rather it is focused on surfacing key issues for further investigation.

Defining key terms and concepts

The literature related to SMEs and competition policy is not uniform in its use of key terms and concepts. In this section, we briefly outline our understanding of these terms.

A common understanding of SMEs

Across the APEC member economies, there are different ways of understanding and defining what constitutes an SME. Definitions draw on measures including employment, capital and assets. There are differences within the particular measures, with SMEs in the United States of America (USA) being defined as businesses with less than 500 staff, while SMEs in Australia and Indonesia require less than 100 staff.² However, while definitions vary across member economies, the majority of SMEs in the region can be characterised as usually employing less than 100 people.³ At a broad level, we use this general characterisation as the starting point for understanding the position of SMEs within a competition policy context and we accept the

¹ APEC, APEC 2015 SME Summit, Innovation and Big Ideas: Pushing Boundaries, 2015, available online.
diverse understandings and definitions of SMEs. This includes ‘Micro Businesses’, such as those noted in terms such as Micro, Small and Medium Enterprises (MSMEs), as being captured by our understanding of SMEs.

**Competition vs. competitiveness**

There is a variation in the understandings of the relationship between competition and competitiveness within the context of SMEs. For example, the majority of policies discussed in studies of SMEs in the APEC region touch on competitiveness and competition related issues; however, they fail to analyse competition policy and law directly. Certain studies erroneously argue that SME competitiveness depends on other factors, such as labour costs and others.\(^4\) Such a view divorces competitiveness and competition. In this report, we take the understanding that competitiveness is a result of competition policy and law – the most direct drivers of such competitiveness.

**Report Structure**

The report it is structured to describe the relationship between SMEs and competition policy and law at a regional level before narrowing to the Philippines. In Section 2 we review the SME sector in the APEC region, focusing on comparisons between member economies. Section 3 presents measures of competition in the APEC region. Section 4 builds on the previous findings and provides recommendations to improve the APEC region’s performance in relation to competition policy and law. Section 5 narrows the scope to focus on the Philippines’ SMEs and competition policy. Section 6 describes the costs and benefits that APEC members would face in reforming their competition policy and law. Section 7 outlines next steps and recommendations.

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\(^4\) See International Trade Centre, SME Competitiveness Outlook 2015, 2015, available online.
2. Characterising SMEs in the APEC Region

This section provides a broad review of SME sector across APEC region and its member economies. First, it characterises SMEs within different APEC member economies. Second, it compares the different policies which affect SME development and competitiveness in the region.

SMEs in APEC Member Economies

Numerous studies have provided general assessments of SMEs within APEC. These have focused on their size, nature and aspects of competition between them. Figure 1 describes SMEs in selected economies in terms of employment and number of enterprises, and highlights the difference in SMEs among APEC member economies.

In many of the higher-income economies, SMEs account for a relatively large share of companies and employment. This is reflected in economies such as the USA, Hong Kong, Chinese Taipei and the Republic of Korea. A notable exception is Japan with SMEs accounting for the least number of companies and employment in the APEC region.

The middle and lower income economies tend to have fewer SMEs and lower employment. Peru is the exception, having SME counts on par with higher income economies. The SME sector of the Philippines remains underdeveloped by APEC region standards in terms of the number of enterprises and level of employment.

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5 See Chris Hall, APEC and SME Policy: Suggestions for an action agenda, 1995, available online. See also Tulus Tambunan, SMEs in Asian Developing Countries, 2009, available online.
7 See Jee-Won Lee and Jae-Hoon Lee, Enhancing the Competitiveness of SMEs in the Southern Economic Corridor in Peru, Korea Institute for Development Strategy Report 11-1051000-000377-01, 2013, available online.
Measures of competitiveness across APEC member economies show significant differences. These differences are reflected in the World Economic Forum’s data, as depicted in Figure 2. It highlights that between 2011 and 2015, competition among APEC’s developing member economies improved at twice the rate of the OECD countries. Competition grew in The Philippines at a faster rate than in economies like Indonesia and Viet Nam, however, overall competition in the Philippines continues to lag behind these other economies. China lags far behind other members in competition, which could reflect the problems Chinese firms face in competing at home and abroad while also indicating an opportunity for other countries looking to trade with China.

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There are different aspects of competition relevant to SMEs in the APEC region. Figure 3 presents the performance of different APEC member economies between 2011 and 2015 based on four indicators: domestic competition, foreign competition, policy and effectiveness of the competition authority, and trade barriers. Figure 3 shows the differences in the change in competitive environments in selected APEC member economies. For example, Russia made the most progress in promoting domestic competition, foreign competition, and reducing trade barriers, while also ranked third in terms of improving anti-monopoly policy. In contrast, the performance of both Chile and Peru slipped during the period. The Philippines showed gains in domestic competition, while also achieving strengthened anti-monopoly law, and reduced trade barriers.

![Figure 3: Change in value related to competition related World Economic Forum indicators between 2011 and 2015 among selected groups and APEC member economies (World Economic Forum, 2016)](image)

The data in Figure 3 show the importance of action at the APEC level. While all economies improved in terms of domestic competition, negative results were common across the other three indicators: foreign competition deteriorated in 14 member economies, anti-monopoly policy deteriorated in 10 member economies, and trade barriers increased in 13 member economies. In some cases, such as Peru’s performance related to trade barriers, competition deteriorated by 20%. At a regional level, the deterioration in competition highlights that there are faltering efforts to address barriers to competition within APEC.11

### Policies that affect SME development and competitiveness

A number of policies have been identified to make SMEs in APEC more competitive and participate in an environment characterised by high levels of competition. As shown in Figure 4, the OECD and Association of South East Asian Nations (ASEAN) Secretariats have developed measures to bolster SME competitiveness.12

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10 These indicators come from the 5th Pillar indicator 1, indicator 2, indicator 6.03 and indicator 6.09 respectively.
11 See OECD, Top Barriers and Drivers to SME Internationalisation, Report by the OECD Working Party on SMEs and Entrepreneurship, 2009, available online.
12 See Sothea Oum, Ponciano Intal, Dionisius Narjoko, Robertus Herdiyanto and Axel Castellane, ASEAN SME Index 2014: Towards competitive and innovative ASEAN SMEs, 2015, available online.
The OECD-ASEAN SME Policy Index provides hints for considering the policies which affect the business environment where SMEs operate. This includes quality measures related to institutional frameworks, access to support services, regulation, access to finance, technology transfer, international market expansion, entrepreneurial education and SME political representation which clearly affect SMEs’ ability to compete domestically and internationally. However, these measures that are captured in the policy index only help if they significantly contribute to the extent of competition.

![SME Policy Index](image)

**Figure 4: Performance of selected APEC member economies in terms of the OECD-ASEAN SME Policy Index (OECD-ASEAN, 2014)**

Many of the economies score reasonably well, with most South East Asian economies scoring around 4 to 5 (out of 6 points). The Philippines comes to only about 66% of the best-in-class policy index score. This points to the need for policymakers in the Philippines to improve SME policy. Local think tanks in the Philippines have shown a progressive attitude toward such indices by developing their own local variants.

**Business regulation**

Business regulation represents one of the most important policies affecting SMEs’ competitiveness. Despite almost 20 years of intensive lobbying and research studies showing the harms of excessive regulation, many APEC member governments still over-regulate businesses. The data show that more competitive economies have less, or better, regulation. Figure 5 shows the country level correlation between the extent of competition and the quality of business regulations. The Philippines, along with Indonesia, ranks the worst in the APEC for business regulation and level of competition. **APEC member economies cannot sensibly address**

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14 Local versions of these indices can focus on details, thereby addressing some of the points that keep a country’s score down. See Rafaelita Aldaba and Fernando Aldaba, Toward Competitive and Innovative ASEAN SMEs: Philippine SME Policy Index 2012, Philippine Institute for Development Studies Discussion Paper 2014-30, 2014, available [online].

15 The APEC Secretariat has contributed to this. See Mikiko Imai, Ollison, Paula Garcia Serna and Anastasia Shegay, APEC: sharing goals and experience, Doing Business 2013, available [online].


17 The two countries appear as one dot in Figure 5 due to the similarity between these two countries’ scores.
competition policy and law until they remove distortions arising from copious business regulation and poor enforcement.¹⁸

Figure 5: Relationship between strength of competition and regulatory quality in APEC member economies (before controlling for other factors) (World Economic Forum, 2016 and World Bank, 2016)

**Tax and export policy**

Tax and export policy and procedures influence domestic and foreign competition. Figure 6 shows the cost of exporting goods from a range of APEC member economies based on World Bank data. Inefficiencies within customs agencies and export regulations and associated charges can contribute to making exports expensive. As Figure 6 shows, there are differences among APEC member economies with their export-related policies and practices. For example, export related costs for Australia are four times greater than the USA. Lower export costs encourage USA based SMEs and other firms to participate in the Australian market. However, the asymmetry precludes Australian firms from competing in USA markets.

Exports from the Philippines cost only half of the comparative costs from Russia or Australia, but are greater than in Indonesia, Thailand, Korea, the USA and Canada. Further reduction in export costs will allow firms to participate in global markets.¹⁹

Figure 6: Comparison of export costs for selected APEC member economies (World Bank, 2016)

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Taxation in APEC member economies has varying effects on competition. Governments raise money that can be invested in telecommunications networks, rail lines, and other public goods. However, taxes also truncate markets at the margin and have the potential of making SME expansion and competition too costly.\textsuperscript{20} As shown in Figure 7, in several APEC member economies, taxes take up to half of SMEs’ profits. The data show that such a drain on profits prevents SMEs from starting up or hiring. This potentially damps SMEs’ incentive to compete.\textsuperscript{21} The Philippines falls into the upper range of tax rates, potentially demotivating SME employment generation and motivation to compete.\textsuperscript{22} \textbf{A shift towards pro-competition tax policy in the Philippines will be a potentially important part of efforts to improve the competition environment.}\textsuperscript{,}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure7.png}
\caption{Relationship between general tax rate and employment in SMEs in APEC member economies (before controlling for other factors) (World Economic Forum, 2016 and World Bank, 2016)}
\end{figure}

\textbf{Financial and banking policy}

Financial and banking policy represents one of the most important policy areas to increase the extent of SME competition in the APEC region. In a capitalist trading system, firms can only compete for access to capital. However, there are hurdles that SMEs face when looking to raise money.\textsuperscript{23} Figure 8 shows the percent of SMEs not served by financial institutions in selected APEC member economies.\textsuperscript{24} In some economies, such as Russia and China, up to 40% of SMEs do not have access to finance. While a smaller proportion of SMEs in Chile have no access to finance, the amount of funds required is significantly more than in other economies. The Philippines falls in the middle of the ranking, with approximately 25% of SMEs unable to obtain finance, and with a financing gap of about US$195,000 per SME.\textsuperscript{25} \textbf{Policies that disadvantage SMEs from obtaining finance can distort competition away from the SME sector.}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure8.png}
\caption{Percent of SMEs not served by financial institutions in APEC member economies}  
\end{figure}

\textsuperscript{21} See Michelle Harding, David Bradbury, Richard Clarke, Korstiaan Kool, Dimintra Koulouri, and Anna Milanez, OECD Tax Policy Studies, Taxation of SMEs in OECD and G20 Countries, 2015.  
\textsuperscript{24} See IFC, IFC Enterprise Finance Gap Database - Raw Data, 2011, available online.  
Increased number and size of SMEs may lead to greater levels of competition. Figure 9 shows the relationship between the number of SMEs and the percent of businesses receiving loans. While exceptions exist, the pattern shows that APEC member economies that provide loans to a higher proportion of companies also have more SMEs.26

The stability of financial sector policies (e.g. quality of getting credit) represents a greater concern than just the extent of distortion in financial policies. As shown in Figure 10, Papua New Guinea and Malaysia exhibit seven times the variability27 compared to jurisdictions like the USA and Peru. Hong Kong and Peru represent the exceptions to this pattern, at both the high and low ends of the scale, respectively. The Philippines emerges at the lower-middle end of each indicator in Figures 9 and 10. Roughly 10% of Philippine businesses receive loans and the jurisdiction has as many SMEs as Chinese Taipei, despite having a much larger population size. Meanwhile, the quality of the credit regulation in the Philippines comes in at roughly half that of Canada and Peru. Banking and financial sector policies significantly affect competition.28

26 While the level of SMEs does to an extent reflect country size and population size, jurisdictions like Chinese Taipei have SME numbers comparable to much larger jurisdictions suggesting that SME numbers depend on policy more than just country size.

27 As defined by the standard deviation of the quality of credit regulation

Lessons from beyond the APEC region

Beyond taxation and availability of financing, policymakers increasingly see competition policy and law as a key factor directly affecting SME performance. Of five econometric studies that investigate the relationship between competition policy and law and economic growth, three find a statistically significant correlation between them.\(^{29}\) However, even in a pro-competition jurisdiction like the United Kingdom, up to 25% of SMEs tolerate anticompetitive behaviour by larger rivals or other SMEs.\(^{30}\)

SME specific policy

While some suggest that SMEs face challenges requiring special attention related to competition policy and law, this is not supported by broader evidence. There are broad contentions that SMEs pose special policy issues because their size makes them vulnerable to market abuse and less likely to attract finance. Their small size makes them more reliant on associations to compete, more vulnerable to seemingly unrelated product/service quality and related regulations, and less

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\(^{29}\) These studies include Voigt (2009), Ma (2011) and Hylton and Deng (2007). The other two studies, Schaper et al. (2010) and Petersen (2013) find no relationship.

\(^{30}\) David Storey, The competitive experience of UK SMEs: Fair and unfair, 17 Small Enterprise Research 1, 2010, available online.
likely to understand, comply with, and use competition law.\textsuperscript{31} For example, Digal notes that the Philippines’ small scale farmers need to merge their operations in order to provide large enough supplies to the supermarket chains.\textsuperscript{32} He notes that in food retailing “high and increasing CRs [concentration ratios] do not support the goal of enhancing competition.”\textsuperscript{33} However, these observations contradict his own appraisal that concentration has made Philippine food shoppers happier and retailers’ quality and service better. There is no evidence that anticompetitive behaviour involving SMEs, as victim or participant, affect broader indices of consumer welfare.

Authors contend that the informal companies which compete with Filipino SMEs stop these SMEs from scaling up their operations to compete in the Philippines’ export markets. A number of studies argue that informal companies can export at a lower cost.\textsuperscript{34} Other cross-country studies confirm these findings, noting that competition from informal enterprises decreases SMEs’ ability to attract finance as well as compete against larger rivals.\textsuperscript{35} If the Philippines reflects trends similar to other developing economies, Filipino SMEs competing against informal rivals have a 16% probability of under-funding compared to their other peers.\textsuperscript{36} These results have led some to argue that “since small firms faced growth constraints that were specific to them, they might require the provision of specialised institutions or instruments that were perhaps inadequate in prevailing market conditions. Such conditions call for government intervention.”\textsuperscript{37} However, \textbf{we found no econometric evidence to suggest that government competition policy/enforcement interventions offering SMEs an advantage actually improve SME performance or customer welfare.}

\begin{flushright}
\textsuperscript{32} See Larry N. Digal, Modern Retail Food Sector in The Philippines: Dominance of Large Domestic Retailers and Their Effects on the Supply Chain, \textit{The International Review of Retail, Distribution and Consumer Research} 25(4), 2015, available online.
\textsuperscript{33} Digal, 2015, at p. 428.
\textsuperscript{35} See Isabelle Distinguin, Clovis Rugemintwari, Ruth Tacneng, Can Informal Firms Hurt Registered SMEs’ Access to Credit? \textit{World Development} 84, 2016, available online.
\textsuperscript{36} Id at. p. 16.
\textsuperscript{37} See Tuano et al., 2014, at p. 29.
\end{flushright}
3. Competition Law in the APEC Region

This section presents measures of competition in the APEC region. It outlines the current context of competition policy and law and discusses various issues related to international cooperation in enforcement of competition policy related initiatives.

Current competition policy and law

Economies with effective competition policies and laws likely, with specific exceptions, have low concentration of firms and prices closer to costs of production. Figure 11 shows the extent to which banks in selected APEC member economies exercise market power. The Lerner Index provides a measure of market power. If the banking sector in these economies reflect situation in other sectors, then these data can help us understand anti-competitive behaviour in these economies. For example, the mark-ups of 40% in Papua New Guinea and China compare unfavourably with the 20% mark-ups of Canadian firms. Differences in market power, and potentially anticompetitive behaviour, do not depend on incomes within an economy. For example, OECD countries do not necessarily have more competitive economies than developing economies. Firms, even in rich countries such as Singapore and Canada, exhibit relatively large changes in market power from year to year. However, economies with overall higher degrees of market power do not necessarily exhibit more policy instability. A harmonisation in regional policies may help to control anti-competitive behaviour across the APEC region.

APEC’s work on controlling anti-competitive behaviour can help facilitate learning among economies with different levels of experience. Figure 12 shows the change over a five-year period in market power. Chile and Singapore saw the largest deterioration in banking sector competition. For Chile, price mark-ups rose by 60% over the five year period. Japan, Viet Nam and Russia showed the largest gains in promoting competitive banking sectors. The evidence

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38 See Ali Mirzaei and Tomoe Moore, What are the driving forces of bank competition across different income groups of countries?, 32 Journal of International Financial Markets, Institutions and Money 1, 2014, available online.
39 We use the statistical meaning of the word “control.” When variation between countries has been eliminated, then coherent policies can be made which affect all countries in the same way.
suggests that there is no clear relationship between an economy’s membership in the OECD (or any other grouping) and the extent to which their economies became more competitive over time. The production of country-by-country assessments is useful for knowledge sharing. **APEC can play a role in disseminating lessons to economies with less developed competition policy regimes.**

![Figure 12: Change in market power between 2006 and 2010 based on the Lerner Index among select APEC member economies (Clerides et al., 2013)](image)

Variation in banking sector market power presents concerns for SMEs. As previously established, SMEs around the APEC region generally suffer from credit constraints. Figure 13 shows that market power, and the mark-ups typically associated with this power, correlate with declines in credit available to the private sector. High mark-ups range anywhere between 20% and 50% of total costs. In other cases, non-competitive banking sectors do not have sufficient incentive to take on the SMEs as they present greater credit risks than large firms.\(^{40}\) If other factors are not significant in explaining these data, then competition policy which helps lower these mark-ups could potentially lead to significant increases in credit.\(^{41}\)

![Figure 13: Relationship between credit provided by financial sectors and the mark-ups earned by financial institutions (World Bank, 2016)](image)

While the most comprehensive quantitative study of competition law across countries is almost a decade old, it still provides an insight into how competition law affects market power, and other

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\(^{40}\) See Maria-Eleni Agorakia, Manthos Delis and Fotios Pasiouras, Regulations, competition and bank risk-taking in transition countries, 7 Journal of Financial Stability 1, 2011, available online.

forms of potential anticompetitive behaviour across APEC member economies.\textsuperscript{42} Table 1 provides an overview of competition law and the status of the competition authority in most of the APEC economies. Among the Asian members of APEC, competition policy and law exhibit wide variation.\textsuperscript{43} North American competition law remains the gold standard worldwide, albeit with too much regulatory complexity.\textsuperscript{44} Latin American competition law, influenced by North American law, has slowly been catching up.\textsuperscript{45} Recent econometric evidence shows that competition authorities reach their peak effectiveness following their own natural evolution only after about 70 years.\textsuperscript{46} \textbf{APEC economies may however utilise some kind of external spur, such as coordination through a forum such as APEC, to improve their competition policy and law.}

\textsuperscript{42} As we discuss later, the age of this study prevents us from relying on it as our sole scope-of-competition-regulation indicator. However, we do include these data in our own composite cross-country index of the scope and enforcement of competition law. See Keith Hylton and Fei Deng, Antitrust Around the World: An Empirical Analysis of the Scope of Competition Laws and Their Effects, Antitrust Law Journal, 2007, available online. See also John Connor, The Private International Cartels (PIC) Data Set: Guide and Summary Statistics, 1990-2013 2014, available online.

\textsuperscript{43} Clifford Chance, A guide to antitrust and competition law in Asia Pacific, 2014, available online.

\textsuperscript{44} Allen and Overy provide specific updates. Readers wanting the detailed rules should consult Hovenkamp. See Allen and Overy, Global Trends in Antitrust, 2013, available online. See also Herbert Hovenkamp, Federal Antitrust Policy, The Law of Competition and Its Practice, 2011.


\textsuperscript{46} See Bryane Michael and Mark Williams, The Cost of Antitrust Law to Malaysia’s Financial Services Sector, 2015, available online.
<table>
<thead>
<tr>
<th>Country</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>China</td>
<td>China now one of the big three jurisdictions to get approvals. Merger control regime set up and other enforcement activities being developed. Large fines for cartel and vertical agreement cases.</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>Telecoms and broadcasting sectors already covered. New competition law coming online but does not have merger control. Expected heavy enforcement.</td>
</tr>
<tr>
<td>Thailand</td>
<td>Competition Act of 1999 and related guidelines, though few cases investigated. No regulations for merger control yet.</td>
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<tr>
<td>Malaysia</td>
<td>Commission received more than 40 complaints since its inception in 2012. Imposed $6 million of fines on Malaysia Airlines and Air Asia.</td>
</tr>
<tr>
<td>Singapore</td>
<td>Well respected competition authority with ample enforcement background, lately related to the anticompetitive exchange of information.</td>
</tr>
<tr>
<td>South Korea</td>
<td>Active competition regulator with over 5,300 cases in 2012 alone with fines totalling around US$430 million.</td>
</tr>
<tr>
<td>Japan</td>
<td>Well resourced and active competition regulator. Imposed US$97 million fine in 2012 on Yazaki.</td>
</tr>
<tr>
<td>Chinese Taipei</td>
<td>Active regulator since 1992.</td>
</tr>
<tr>
<td>Brunei</td>
<td>Still no competition law or agency.</td>
</tr>
<tr>
<td>Australia</td>
<td>Its cross-border primary materials trade adds a significant dimension to its competition cases. With an active merger control regime; in December 2013, saw prosecutions of a global industrial firm and Australian retailer.</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Competition agency conducts market studies and reviews government policies, as well as pursuing enforcement actively. A large number of cases relate to tender fixing, cartels, abuse of market power and mergers.</td>
</tr>
<tr>
<td>Peru</td>
<td>Antimonopoly provisions in Peruvian constitution (art 61), leniency rules only in 2012 and increasing dawn raids.</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>Cartels with more than 50% of the relevant market not allowed. Imposed fines on insurance companies in 2010 and worked on case involving cinema operators more recently.</td>
</tr>
</tbody>
</table>

Source: Clifford Chance for Asia Pacific, Fernandez (2015) for Peru and Allen & Overy for others.

Significant shortcomings in competition policy and law of some APEC member economies prevents a larger role for peer assessment and detailed consideration of specific antitrust provisions. Numerous fora, such as OECD and UNCTAD, already provide for such peer assessment which have been found to be a valuable exercise. Both assessment exercises include subsets of APEC’s membership; however, neither provides adequate detail to be useful for working level competition officials. Recent analysis reveals that countries’ experimentation provides a far inferior method of improving competition policy and law than simply copying successful models. APEC can support peer review of competition policy and law conducted by the international community by building political support and sharing specific information about competition related regulation.

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47 See Emily Fox, Competition law and the millennium round, 2 Journal of International Economic Law 4, 1999, available online.

48 For an example, see John Clark and OECD, Peer Reviews of Competition Law and Policy in Latin America: A Follow-up on Argentina, Brazil, Chile, Mexico, Peru, 2007, available online. See also IDB and OECD, Follow-up to the Nine Peer Reviews of Competition Law and Policy of Latin American Countries, Inter-American Development Bank Integration and Trade Sector Technical Note IDB-TN-624, 2013, available online.

49 See Lilit Melikyan, External evaluation of UNCTAD peer reviews on competition policy, UNCTAD/DITC/CLP/2014/5, 2015, available online.


International cooperation in enforcement

International cooperation increasingly promotes convergence between APEC member economies’ competition policy and law. As previously described, informal mechanisms like peer review have served as more effective ways of promoting competition policy and law reform than international treaties.\(^{52}\) However, international cooperation on competition related issues clearly represents an increasing trend among APEC member economies.\(^{53}\) In the early 2000s, cooperation on competition related issues strengthened to a point where commentators could talk about a “global competition law.”\(^{54}\) Most commentators accept that competition policy suffers from a type of “anti-trust externality” whereby countries engage in too little competition policy cooperation.\(^{55}\) If APEC attempts to promote international cooperation in competition policy and law, it should learn lessons from the experience where numerous others failed.\(^{56,57}\) Any APEC work on competition policy and law would need to identify the obstacles which undermined previous attempts at multilateral cooperation and spur member economies to take action on their own.\(^{58}\)

These obstacles usually involve the most intractable issue of all – politics. Figure 14 shows the obstacles and constraints on international cooperation on competition related issues, as reported by civil servants themselves.\(^{59}\) International cooperation focuses on building capacity and facilitating investigations. Legal limits and low willingness to cooperate represent the largest obstacles, with a technocratic view of cooperation ignoring the vital role of politics. Recent analysis identifies that ASEAN’s efforts at encouraging cooperation on competition policy in Asia suffer from the same weakness.\(^{60}\) Stronger analysis of competition policy cooperation has traced the roots of cooperation to political settlements between businessmen and the public officials in their countries.\(^{61}\) APEC provides the best forum for engaging in the politics needed to forge international cooperation on competition policy and law.

\(^{52}\) See Chad Damro, Transatlantic Competition Policy: Domestic and International Sources of EU-US Cooperation, 12 European Journal of International Relations 2, 2006, available online.


\(^{54}\) See Daniel Tarullo, Norms and Institutions in Global Competition Policy, 94 American Journal of International Law 3, 2000, available online.

\(^{55}\) See Alan Sykes, Externalities in Open Economy Antitrust and Their Implications for International Competition Policy, 23 Harvard Journal of Law and Public Policy 89, 2000, available online.


\(^{58}\) See Ahmed Melamed, International cooperation in competition policy and law: what can be achieved at the bilateral, regional, and multilateral levels, 2 Journal of International Economic Law 3, 1999, available online.


\(^{60}\) See Cassey Lee and Yoshifumi Fukunaga, ASEAN regional cooperation on competition policy, 35 Journal of Asian Economics 1, 2014, available online.

\(^{61}\) See Hubert Buch-Hansen and Angela Wigger, Revisiting 50 years of market-making: The neoliberal transformation of European competition policy, 17 Review of International Political Economy 1, 2010, available online. See also Yannis Karagiannis, Collegiality and the Politics of European Competition Policy, 11 European Union Politics 1, 2010, available online.
Extra-territorial application represents one important competition law provision which depends largely on political settlements between APEC member economies. Many competition laws with extra-territorial applicability only come into practice when business activity in one country significantly and adversely harms another countries’ producers or consumers. Regardless of the law supporting extra-territoriality, the application of any competition policy and law across borders requires pre-existing agreements and political compromises. Such politics can support the application of competition legal provisions and policies, like extra-territorial application, to protect domestic companies and stifle competition. In the context of the European Union, studies identified that national judiciaries’ ruling is based on political, rather than purely legal, criteria. Unfortunately, no data exist to validate whether the application of extra-territoriality and other competition law provisions is “excessive” or not. APEC could assist efforts to collect objective data on competition related cases, judgments, enforcement actions, and so forth as a way to facilitate competition policy stakeholders to reach a political consensus.

Figure 14: Objectives and limitations of cross-border cooperation on competition related cases, as reported by OECD competition agencies (OECD Competition Commission, 2013)

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62 See Andrew Guzman, Cooperation, Comity, and Competition Policy, Oxford University Press, 2010.
64 See Damien Geradin, Marc Reysen, and David Henry, Extraterritoriality, Comity and Cooperation in EC Competition Law, 2008, available online.
4. Possible Reform in the APEC Region

This section provides an outline of possible reforms in the APEC region. First, it presents options for international reporting which could benefit APEC. Second, it discusses the benefits of promoting a culture of competition among SMEs. Third, it highlights the benefits of encouraging members to grant independence to competition authorities. Fourth, it discusses the impact of promoting confidentiality, transparency and accountability. Fifth, it discusses the benefits of understanding work on competition as ‘public goods’. Finally, it distills some recommendations for improving competition policy and law in APEC.

Options for international reform

Numerous authors have put forward proposals for competition policy and law reform. Inotai and Ryan suggested general principles for competition agencies in the APEC region.69 Key among their proposals included requirements to engage in strategic planning and prioritisation of sectors to study and enforce in the conduct of ex-hoc and post-hoc evaluation, and better information dissemination and communication. Son highlights the problems faced by most developing country competition agencies, including Vietnam. These include lack of regulatory experience, lack of resources, conflicts in existing laws, difficulties of promoting international competition cooperation, and lack of ability to tackle international cartels.70

APEC could collate and analyse international competition policy and law statistics which national competition authorities make available online. Serebrisky provides comparative data on competition authorities as a way of benchmarking performance.71 As documented in a recent OECD study, since 2000 the number of competition agencies in the world increased from 80 to more than 120.72 The number of filings for cross-border merger and acquisition deals requiring regulatory notification or approval from six or more competition authorities has increased from 4% in 2000 to around 13% by 2013.73 The dramatic increase in the number of competition authorities within APEC suggests the importance of monitoring performance statistics.

The data show two different groups of competition authorities worldwide. Some high performing authorities handle well over 50 cases in a particular year while others handle less than 10 in a year.74 Albeit this comparison does not capture the number of issues that are resolved prior to becoming a ‘case’, the nature of competition, as well as the size and complexity of their

69 See Andras Inotai and Stephen Ryan, Improving the effectiveness of competition agencies around the world - a summary of recent developments in the context of the International Competition Network, 2 Competition Policy Newsletter 1, 2009, available online.
70 Son notes that according to World Bank studies, the value of cartel affected imports to developing countries was more than USD 80 billion, from just 16 cartels, during 1990s. See Tran Anh Son, Challenges Facing New Competition Enforcement Agencies: The Vietnamese Experience, Presentation at the American Bar Association Committee on International Competition Issues, 2006, available online.
72 OECD, Challenges of International Co-operation in Competition Law Enforcement, 2014, at Fig. 9, available online.
73 Id at Table 3.
74 Serebrisky, supra, at p. 6, 9 and 13.
economies, can explain part of these differences. Figure 15 provides an overview of these differences. The competition authorities in OECD economies have up to four times as much experience cooperating with other authorities than their non-OECD counterparts. Competition authorities everywhere usually focus on some types of cases more than others. For the period 2007 to 2012, less than 15 agencies had experience dealing with abuse of dominance cases. Differing competition policies and laws explain part of these differences as many competition authorities, or the law that governs them, still exempt some sectors from competition provisions. Smoothing out differences between lagging and leading competition authorities is likely to require coordinated action through international cooperation afforded through APEC.

Figure 15: Number of competition authorities cooperating on cases between 2007 and 2012, and the number of competition authorities with experience in key areas (OECD, 2014)

Promoting a culture of competition among SMEs

Competition policy and law only gain prominence with strengthening of a jurisdiction’s culture of competition. Most authors looking at the promotion of the effectiveness of competition policy and law note that culture affects the level of competition in a country more than legal drafting or administration prowess. Tambunan and Chandra contend that entering into more extensive free trade agreements (FTA) exposes firms to the competition needed to help them see the advantages that competition generates over time. For example, Figure 16 shows how local Thai SMEs rely on these types of agreements as they compete in other markets. On average, 30% Thai SMEs rely on free trade agreements to compete abroad. Therefore, FTAs can be beneficial to SMEs and can be an effective way to expose SMEs to competition.

75 Several studies have shown how much local economic conditions should dictate a competition authority’s workload. Any workload shortfall not explained by local economic conditions must therefore occur due to the competition authority’s inefficiency. For an example of such a study (albeit coming from outside the APEC region), see Maria Vagliasindi, Competition across transition economies: an enterprise-level analysis of the main policy and structural determinants, EBRD Working Paper 68, 2001, available online.
76 Serebrisky, supra, at p. 5.
78 Tulus Tambunan and Alexander Chandra, Utilisation Rate of Free Trade Agreements (FTAs) by Local Micro-, Small- and Medium-Sized Enterprises: A Story of ASEAN, 2 Journal of International Business and Economics 2, 2014, available online.
Figure 16: Percentage of Thai SMEs resorting to free trade agreements to gain access to foreign markets (Tambunan and Chandra, 2014)

Competition authorities react to macroeconomic indicators, pro-cyclically promoting or restraining competition and, as a result, can harm SMEs’ ability to rely on stable competition policy and law. As previously noted, policy instability is one of the clearest impediments to promoting competition in the APEC region. Competition lags due to the lack of competition authorities’ focus and policy prioritisation, especially in instilling a culture of competition-focused commerce.

Figure 17 summarises the other major factors that influence increased competition authority action. Antitrust activity increases as competition authorities obtain access to more resources. However, the size of the SME sector, in itself, has no significant effect on antitrust agency activity.

Figure 17: Extent to which antitrust activity increases in relation to various macroeconomic factors (Feinberg and Reynolds, 2010)

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79 Khemla Armoogum and Bruce Lyons, What Determines the Reputation of a Competition Agency?, 2014, available online.
80 See Strategic Priorities of Competition and Regulator Agencies in Developing Countries, author and data unknown, available online.
81 This study focuses on state-level antitrust activity in the US – thus the extent to which such trends persist in an international context remain to be seen. Yet, these data represent some of the only data about these relationships. See Robert Feinberg and Kara Reynolds, The Determinants of State-Level Antitrust Activity, 37 Review of Industrial Organisation 1, 2010, available online.
82 Numerous other studies of competition authorities come to a similar finding. Santos et al. for example show rather revealing (if dated) data on the number of agencies engaging in policy prioritisation. See Ilana Santos, Lerzan Unal, Patricia Araujo, Rafael Furtado, and Renata Dantas, Agency Effectiveness Project, 2008, available online.
Encourage independent competition authorities

Establishing the independence of competition agencies represents an easy method of improving their performance and harmonising policies across the APEC region. As UNCTAD notes, such independence does not need to be unconditional. Provisions establishing the independence of competition authorities may include provisions for the ministry overseeing competition issues to assert control under specific predefined circumstances. Such provisions need not remove responsibilities from sector regulators overseeing competition within their competence. In many cases, representatives from several ministries, agencies or parts of the government may sit on a competition commission or oversight board in order to deal with the cross-sectoral issues and overlapping topics related to competition policy. Allowing the competition authority to use part of the financial resources obtained through enforcement and collection of fines would also help to ensure the competition authority’s independence.

Previous research establishes the relative importance of competition law in determining the effectiveness of a competition authority. Figure 18 illustrates the main factors associated with a competition agency’s “effectiveness”. They find that actual (or de facto) independence correlates much more with effectiveness than formally legislated (or de jure) independence. Competition authorities which follow an economic approach to competition policy and law tend to be effective. Meanwhile, income and the basis for competition law correlate negatively with a competition authority’s effectiveness.

83 UNCTAD, Independence and accountability of competition authorities, 2008, available online.
84 Id at para 20.
85 Id at para 19.
86 The authors helpfully provide a partial list of institutional arrangements for several APEC member countries. See Id at para 22.
87 Id at para 25 and 26.
90 The de jure independence variable in the figure does not statistically significantly differ from zero.
91 The variable explanations are as follows. De facto independence refers to whether the competition law provides for the agency’s independence. Economic approach refers to whether the agency takes an economic approach to analysing competition looking at harms, marginal costs and so forth. The year variable picks up any unusual effect in that year (such as an economic shock). The freedom proxy represents a measure of freedom in the jurisdiction. Income refers to incomes per capita in the jurisdiction. The basis for competition law variable tries to pick up effects for jurisdictions with differing legal bases for the competition authority. The percent of variation explained (popularly known as R²) measures the extent to which the regression explains variance in the competition agency’s effectiveness.
Some authors argue for including competition authorities’ independence as a part of any cross-country quantitative comparison. Figure 19, for example, shows independence rankings for competition authorities in several APEC economies. Using these 10-year-old data, the USA appears as the most independent competition agency,\(^\text{92}\) while Chinese Taipei and Chile had the least independent competition authorities.\(^\text{93}\) Within the independent sectoral level regulators with the competence for enforcing competition related policy and law, authorities supervising excisable goods (tobacco and alcoholic drinks) exhibit the most independence. The aviation authority exhibits the least. These data serve as a useful benchmark to assess the past, present and future of independence among APEC competition authorities.\(^\text{94}\) Independence only represents one issue in a range of issues important for determining the extent and quality of competition in a jurisdiction.\(^\text{95}\) The conclusion remains that membership in a regional fora can promote the independence and effectiveness of a competition authority.\(^\text{96}\)

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\(^{92}\) The authors assessed all the competition authorities in these countries. See original study for more on their methods.

\(^{93}\) The George Washington Competition Law Center provides readers interested in a checklist of provisions contained in Chinese Taipei’s (and other countries’) competition policy. See The George Washington Competition Law Center, Taiwan Competition Framework, 2012, available online.

\(^{94}\) See Fabrizio Gilardi and Martino Maggetti, The independence of regulatory authorities, 2010, available online.


\(^{96}\) See Joan-Ramon Borrell and Juan Luis, The drivers of antitrust effectiveness, 185 Spanish Finance Ministry Public Economics Journal 2, 2008, available online.
Confidentiality, transparency and accountability

Competition authorities need to exchange confidential information during the investigation of cross-border antitrust cases. Competition authorities in countries with similar legal and economic systems tend to share information more readily. However, there is great diversity among APEC member economies. As Demedts observes, “the lack of exchange of protected or confidential information is widely regarded as one of the main obstacles for international cooperation.” Any action APEC can take to promote the sharing, security and continued confidentiality of information can promote international cooperation on competition related issues. The International Competition Network’s (ICN) guidance, at least on mergers, tends to favour the protection rather than sharing of confidential information. The ICN’s guiding principles for mergers encourage competition authorities to “enhance the efficiency and effectiveness of the review process and reduce transaction costs” while providing “for the protection of confidential information.” The guidelines do not directly encourage competition authorities to share information. Many such agreements in place between competition authorities make sharing information voluntary rather than mandatory. The 2005 best practices guidance by the OECD specifically focuses on information sharing, describing procedures and various rights and duties. APEC member economies can extend existing agreements by making more information sharing mandatory.

97 See Valerie Demedts, Confidential information exchange in competition cases: perception versus reality in the EU and US, 9th ASCOLA Conference Warsaw 2014 on procedural fairness in competition proceedings, 2014, available online.
98 Id at p. 4.
There is a tendency for competition authorities to not share and publish sufficient competition related information. Table 2 compares competition related provisions in the law of different member economies. The table shows that upper income APEC members generally provide more information regarding various aspects of their competition policy and law. In comparison, lower-income members tend to not do so.

Table 2: Comparison of whether information related to key areas of competition policy and law is provided by the competition authority among APEC member economies

<table>
<thead>
<tr>
<th></th>
<th>Cartel investigations</th>
<th>Unilateral abuse of dominance</th>
<th>Merger review</th>
<th>Market studies</th>
<th>Technical assistance and capacity building</th>
<th>Competition policy issues</th>
</tr>
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<tbody>
<tr>
<td>Australia</td>
<td>Y</td>
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<td>Y</td>
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</tbody>
</table>

Y=yes, N=no and Y/N means the jurisdiction has elements of each variable shown. Blank cells indicate the original source did not provide information.

Source: Davydova (2012), Table 3 at p. 67 and subsequently updated by authors.

There are significant variations among APEC member economies in relation to how they report information on competition policy and law. The lack of information dissemination related to competition policy and law can be a limiting factor for the sharing of lessons among different member economies.

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104 See Ilana Santos, Lerzan Unal, Patricia Araujo, Rafael Furtado, and Renata Dantas, Agency Effectiveness Project, 2008, available online.
105 The European Union experience provides many valuable lessons for other regions (despite the differences between APEC and EU countries). See Firat Çnegiz, An Academic View on the Role and Powers of National Competition Authorities, IP/A/ECON/2016-06, 2016, available online.
APEC Secretariat Work on Competition “Public Goods”

APEC work on competition issues has the potential to save member economies significant resources in studying and adapting to other economies’ policies. As previously noted, the centralised undertaking of research in relation to competition policy across APEC member economies could be far more cost effective than individual countries attempting to do so themselves. No one economy can try to take the place of an APEC type organisation in coordinating international work on competition policy and law issues. Having one economy bear responsibility for the database is unlikely to result in an up-to-date, fully populated database. Nor can one organisation simply put a database on the Internet and expect officials from member economies to keep information about their country up-to-date. Meanwhile, APEC’s own Competition Policy and Law Group meets annually to “update other members on their respective competition policies and laws, including recent cases. In the annual meeting, challenges to competition policy and competition advocacy efforts are also discussed,”\(^\text{106}\) while only limited information appears online. **APEC could consider investing resources to better coordinate and publish competition policy and law activities in a timely manner.**

Similarly, surveys conducted across APEC member economies could help measure the extent to which SMEs face anticompetitive behavior; these could also allow countries compare their performance vis-a-vis each other. The Competition Commission of Singapore’s survey of SMEs resulted in only 46% of SMEs thinking that “consumers are adequately protected from unfair business practice”, 45% thinking that “goods and services are reasonably priced” and only 39% thinking that “all businesses compete on a level playing field.”\(^\text{107}\) In Viet Nam, many SMEs do not know about existing law and many companies are perceived as “uncompetitive.”\(^\text{108}\) Roughly 44% of state-run companies are considered “uncompetitive,” with 20% of private firms uncompetitive, and 10% of foreign firms uncompetitive.\(^\text{109}\) **The APEC Secretariat’s efforts to support SMEs and training on antitrust issues could stimulate competition in the APEC region.**

Benchmarking particular provisions in various APEC member economies’ competition law and regulation could help push the peer review process along. **Error! Reference source not found**

\(^{106}\) See APEC, Competition Policy and Law Group, 2016, at paragraph 3, lines 2-3, available [online].

\(^{107}\) The Competition Commission of Singapore, Perception and Awareness Survey Chief Executive Presentation, 2009, available [online].

\(^{108}\) Thi-Thanh-Hui Tran, Challenges of Small and Medium-Sized Enterprises (SMEs) In Vietnam during the Process of Integration into the ASEAN Economic Community (AEC), 5 International Journal of Accounting and Financial Reporting 2, 2015, available [online].

\(^{109}\) Id at Table 1.
found.21 shows the 2007 index values of each economy’s scope of competition law.\textsuperscript{110} If APEC is successful in implementing the survey of competition authorities and updating of studies like these, such outputs would form important “public goods.”

![Graph showing comparison of competition law index scores among selected APEC member economies (Hylton and Deng, 2007)](image)

**Figure 21:** Comparison of competition law index scores among selected APEC member economies (Hylton and Deng, 2007)

**Recommendations for APEC**

There are a number of recommendations and next steps which could be taken by APEC which could address a number of the issues raised in this previous section. These are briefly outlined below.

1. **Facilitate member economies’ engagement in peer review related to competition policy and law, particularly as it pertains to SMEs.** Promoting the knowledge sharing and best practice among member economies could bring strong benefits. This is particularly important in promoting lessons for economies with less developed competition policy regimes particularly on successful strategies to reduce anticompetitive behaviour over time.

2. **Assess the feasibility of hosting a centralised database on competition measures accessible to APEC member economies.** This would ensure the availability of information updated online regularly and could serve as a conduit for SME studies, information and other resources for SMEs.

3. **Promote greater dialogue on cross-jurisdictional cooperation in relation to competition policy and SMEs.** As working across borders becomes the norm, APEC could ease the transition for many member economies through guidance on how extra-territorial application affect these countries as well as facilitating the transfer of information and evidence.

5. SME Competition in the Philippines

This section provides a more detailed assessment of SME and competition in the Philippine context. First, it assesses the development of SMEs within the Philippines. Second, it outlines a number of important contemporary factors for competition policy and law in the Philippines, specifically in light of recent changes to legislation and the establishment of the PCC.

SME Development in the Philippines

The Philippines has adopted SME friendly legislation since the early 1990s. Table 3 shows some of the major legal instruments attempting to encourage SME development in the Philippines. A salient feature of this early legislation includes the creation of a Council with the responsibility to review, monitor, evaluate and comment on SME development policies and institutions.\(^{111}\) The Bureau of Micro, Small Medium Business Development sits alongside the Council in the Department of Trade and Industry, helping with administration and implementing decisions taken by the Council. One of these successful policies includes establishing a central location for start-ups for SMEs, whereby an SME can register its name online and register with several government agencies, such as social security, health and so forth, at once. The reform brought down the number steps and days required to start a business from 16 and 34 to 6 and 8, respectively.\(^{112}\)

Table 3: Key legal instruments government SMEs in the Philippines

<table>
<thead>
<tr>
<th>Reference</th>
<th>Law and Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Republic Act No. 9501 (2008)</td>
<td>Magna Carta for MSMEs Amends the previous act and recognises the broader class of micro-enterprises.</td>
</tr>
<tr>
<td>MSMED Plan 2011-2016</td>
<td>Six-year Micro, Small and Medium Enterprises Development Plan In theory, to the extent provisions from this plan form executive obligations under Philippine Development Plan, the plan would serve as administrative law. However, the broad abstract nature of the plan makes the it much like the broad acts reviewed above.</td>
</tr>
</tbody>
</table>

Policies in the Philippines designed to help SMEs have had varying levels of success. There are a number of initiatives which have produced positive results. The establishment of the Small

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\(^{111}\) From Act 6977 to Act 9501, the council morphed from being the Small and Medium Enterprise Development Council to the Micro Small and Medium Enterprise Development Council. See Rep. Act No. 6977, Sec. 7-B, as amended by Rep. Act No. 9501. See Government of The Philippines, An Act to Promote, Develop and Assist Small And Medium Scale Enterprises through the Creation of a Small And Medium Enterprise Development (SMED) Council, and the Rationalization of Government Assistance Programs and Agencies Concerned with Development, 1991, available online. See also Government of The Philippines, An Act to Promote Entrepreneurship by Strengthening Development and Assistance Programs to Micro, Small And Medium Scale Enterprises, Amending for the Purpose Republic Act No. 6977, as Amended, Otherwise Known as the “Magna Carta For Small Enterprises” and for other purposes, 2008, available online.

\(^{112}\) Department of Finance, SEC Integrated Business Registry Makes Incorporation Faster, Easier, 2016, Available online.
Business Guarantee and Finance Corporation is one of these initiatives, with the Corporation providing finance, information, training and marketing services to local SMEs.\textsuperscript{113} Philippine law envisions the establishment of a Venture Capital Fund and Micro Finance Fund, providing unsecured loans to these SMEs which should produce positive results.\textsuperscript{114} Special programmes to guarantee SME loans and lower requirements for listing on an SME version of the Philippine Stock Exchange also fall into this positive category.\textsuperscript{115} Other initiatives have not had such positive impacts. For example, the results of the MSMED Plan have been largely neutral\textsuperscript{116} reflecting that the Plan only tangentially addresses issues on improving the competitiveness, and competitive environment where SMEs operate.\textsuperscript{117} An initiative to extend credit to SMEs, but without success, is the requirement that financial institutions must loan 8\% of their lendable funds to Philippines SMEs, at least until 2018, or face fines.\textsuperscript{118}

In the Philippines, the number of SMEs by far outnumbers larger companies. Of the approximately 947,000 registered businesses in 2014, 943,000 consisted of SMEs\textsuperscript{119} and only 4,060 are large enterprises. This shows the importance of SMEs in the Philippines. The lack of growth of these SMEs over the last 15 years highlights the obstacles they face. From 2000 to 2010, their numbers hovered at around 800,000. Only in 2012 did the number of SMEs increase by around 12\% to their present number. Noticeably, the composition of SMEs by size as well as the sectors they serve has remained constant. Their value-added has also remained stable, at around 36\% of GDP.\textsuperscript{120}

A broad assessment of the Philippines’ SME sector points to the need to ensure that competition policy is conducive to SME development. Error! Reference source not found. shows the number of SMEs in various sectors of the Philippine economy while Error! Reference source not found.depicts the distribution of SME workers. These figures highlight that the largest concentration of SME numbers and employment centres on trade, hospitality, manufacturing and other services. Many of the SMEs in these sectors represent lower tech, lower skilled firms without a sustained competitive advantage and tend to suffer the most in an environment with more vigorous competition law and policy. These might partially explain why reform for SME development has not occurred as quickly as elsewhere in the past. Competition policy may need to be accompanied by strategies to encourage innovation that can increase productivity in the wholesale/retail markets, hospitality, and manufacturing where more than 80\% of all SMEs and their employees work.

\begin{itemize}
  \item \textsuperscript{113} Rep. Act No. 6977 (as amended by Rep. Act No. 9501), at Sec. 11.
  \item \textsuperscript{114} Id at Sec. 14
  \item \textsuperscript{115} Id at Sec. 9, par. 4 for the first policy. See also Philippines Stock Exchange, Listing & Disclosure Rules, 2016, available online.
  \item \textsuperscript{116} Philippines Department of Trade and Industry, Micro, Small, and Medium Enterprise Development (MSMED) Plan, 2010, available online.
  \item \textsuperscript{117} Id at Sec. Access to Markets (A2M)
  \item \textsuperscript{118} Id at Sec. 15
  \item \textsuperscript{119} Philippines Statistics Authority, 2012 Census of Philippine Business and Industry – Economy-Wide for All Establishments: Final Results, 2012, available online.
  \item \textsuperscript{120} See Asian Development Bank, Asia SME Finance Monitor 2013, at pp: 110-112, See also Department of Trade and Industry, MSME Statistics, 2016, available online.
\end{itemize}
The way SMEs in the Philippines use, or do not use, available financial resources through formal channels provides clues on the extent of how competition policy and law could improve SME competitiveness. A study which reported interviews with senior officials in major financial institutions in the Philippines noted that the majority of financial institutions failed to disburse 8% of their loanable funds to SMES as required by the Magna Carta, despite penalties.\textsuperscript{121} To put this in context, between 2001 and 2012 lending from the entire banking sector increased by 155% whereas credit for micro and small loan portfolios only increased by around 30%.\textsuperscript{122} Out of the 19 universal banks, 14 failed to lend the minimum amounts to micro and small enterprises and only 6 lent to medium-sized enterprises.

In addition, high taxes explain part of the limited demand for loans among SMEs as taxes and mandatory contributions come to roughly 45% of their annual profits.\textsuperscript{123} Tax and administrative burdens inhibit Filipino SMEs’ incentives to compete and expand, even with the best laid competition law and policies conceivable.

**The 2015 Philippine Competition Act**

The 2015 Philippine Competition Act serves as the first major piece of legislation on anti-trust/competition. The newly established PCC issued its implementing rules and regulations on June 3, 2016 for application one month later. The Act’s guiding principles correspond with

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\textsuperscript{121} Interview with Benel Lagua, Executive Vice President and Chief Development Officer of the Development Bank of the Philippines and Chief Executive Officer of the Industrial Guarantee and Loan Fund, interviews conducted in 2016. Contact authors for associated source materials.

\textsuperscript{122} In all fairness, lending to Philippine medium-sized firms increased by about 145%, just slightly under the overall lending growth rate in the country.

modern competition law and its insistence on promoting consumer welfare, breaking up anticompetitive combinations and prohibiting the abuse of market power.\textsuperscript{124} The Act also creates the basis for an independent competition commission.\textsuperscript{125} Given the similarity of the Philippine legislation to standard competition law, we do not review the Act in more depth.\textsuperscript{126}

Numerous econometric studies point to the likely effects of the competition law, if enforced. In a study\textsuperscript{127} of Philippine manufacturing firms using econometric methods to identify relationships among productivity, profitability and competition, manufacturers appear relatively unresponsive to incentives aimed at increasing innovation and profits.\textsuperscript{128} As of 2012, these results show that structural change needs to occur in the Philippines before competition can significantly improve firms’ profits. For the banking sector, the concentration in the Philippines coincided with lower profits and lending.\textsuperscript{129} In poultry markets, evidence shows significant market power is present.\textsuperscript{130} As shown in Table 4, other sectors exhibit significant mark-ups and market power.\textsuperscript{131} For example, electricity markets show that even if policy tackles concentration, such deconcentration may not necessarily lead to lower mark-ups.\textsuperscript{132} Where significant efficiency gains are expected, the Philippine Competition Commission could advocate for policies that will facilitate entry of new players in highly concentrated markets.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Top 4 Concentration Ratio</th>
<th>Mark-up*</th>
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<tbody>
<tr>
<td>Flat glass</td>
<td>82%</td>
<td>50%</td>
</tr>
<tr>
<td>Refined petrol</td>
<td>80%</td>
<td>29%**</td>
</tr>
<tr>
<td>Tobacco</td>
<td>72%</td>
<td>59%</td>
</tr>
<tr>
<td>Beverages</td>
<td>62%</td>
<td>62%</td>
</tr>
<tr>
<td>Food</td>
<td>56%</td>
<td>29**</td>
</tr>
<tr>
<td>Motor vehicles</td>
<td>57%</td>
<td>29**</td>
</tr>
</tbody>
</table>

*Roeger Method

** Industry averages used to approximate these mark-ups because of lack of other data

Table 4: Concentration and market power in selected Filipino industries

The PCC should consider proposing policies aimed at tackling sectors dominated by only a few owners. Keenan, distilling over 20 years of academic and practitioner findings, notes that “huge sectors of Filipino industry (such as banking, telecommunications, and property development) are

\textsuperscript{124} Philippine Competition Act (Rep. Act No. 10667), Section 2.
\textsuperscript{125} Rep. Act No. 10667, Sections 5, 6 and 7
\textsuperscript{126} A number of recent guides provide a detailed background on the new act. See Dave Poddar, A guide to the Philippine Competition Act, Clifford Chance Client Briefing, 2015, available online.
\textsuperscript{128} ibid
\textsuperscript{129} Of course, underlying relationships may exist which such simple correlation misses. See Lim, Edralin, Competition and Efficiency of Selected Universal Banks in The Philippines for 2011, International Journal of Information Technology and Business Management 11(1), 2013.
almost entirely monopolised by a few elite political families.” In a large econometric study, Mendoza et al suggested that “political dynasties” in the Philippines thrive on economic dynasties. Significant evidence suggests that politics in the country will not allow an agency like the PCC to propose open, large-scale reforms tackling entrenched concentration. The Commission can take small steps and learn from other ASEAN members. Regardless of the feasibility of action, the existence of politically connected oligarchs in the Philippines represent a significant barrier to pro-growth competition.

Given the new Philippine competition law and the national competition policy, we cannot assess the likely efficacy of enforcement, oversight and such efficacy of the PCC.

**Recommendations for PCC**

The PCC will require time for it to mature and establish credibility across the Philippine economy. However, there are a number of activities that the PCC could consider.

- **Develop a strategy for addressing issues in sectors with only a few owners.** The report highlighted that portions of the industry in the Philippines are highly concentrated. Persistent barriers to entry in sectors where new entrants can potentially improve efficiency could preclude pro-growth competition. While it may not be politically possible for the PCC to propose open, large-scale reforms tackling entrenched concentration, the Commission can take small steps and learn from other APEC economies.

- **Promote a shift towards pro-competition tax policy in the Philippines.** This will be a potentially important part of efforts to improve their competition policy and law.

- **Rectify issues relating to distortions arising from business regulation and poor enforcement.** Excessive business regulation was noted in the report as being a key inhibitor of greater competition for SMEs.

At a broader level, the following are recommendations for the PCC to consider in future activities.

1. **Focus on establishing a strong track record and reputation for success.** Most competition agencies require decades to reach their full effectiveness, including establishing a record for fairness and effectiveness. This should include understanding the competition environment at a holistic level.

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135 For econometric evidence on the on-going entrenchment of social elites in the Philippine political process, see Cesi Cruz, Julien Labonne and Pablo Querubin, Politician Family Networks and Electoral Outcomes: Evidence from The Philippines, 2015, available online.
2. **Focus the attention of the PCC on priority areas.** If the PCC plans too many activities at the start, there is the risk of resources and capabilities being spread too thin.

3. **Engage with SMEs, including consideration of training and awareness raising activities, related to their legal obligations and rights.** In general, SMEs are likely to be more in need of greater support in understanding their legal obligations and rights than large companies which can hire compliance and legal staff. The PCC’s role could include the provision of training and relevant materials targeted to SMEs.

4. **Work with business associations and representative groups.** The PCC can cooperate with business associations and trade groups to educate large numbers of SME managers. Experience across APEC has shown that this is an effective way for commissions to disseminate information on competition law and policy.

5. **Ensure the relevant staff within the PCC are equipped with adequate skills and capabilities to undertake their work.** PCC staff should be adequately supported so that they are able to detect anticompetitive practices involving or harming SMEs and investigate these practices. This includes having the capacity and tools available to evaluate SMEs’ competitive environment. Such capacity and tools will likely include economic and legal analysis, as well as field-work competencies to know how to manage investigations on the ground. PCC staff will need to pay particular attention to methods of investigating large numbers of SMEs which keep incomplete records. This could include the commissioning of specific training and mentoring activities.

6. **Ensure the relevant staff within the judiciary are equipped with adequate skills and capabilities to undertake their work.** Judges need to be well positioned to adjudicate competition related cases and related appeals. As in many jurisdictions, Philippine judges may be tasked with adjudicating competition related cases where they have no expertise or little experience. There could be opportunities to draw upon APEC member states’ materials and experiences.

7. **The PCC should work with APEC in sharing their experience with other member economies.** This may include the recording of lessons learned and evaluation of key policies and activities that could be applicable to the larger competition community. If done well, such documents could yield important insights about competition useful to other jurisdictions. Trade-related studies could also promote cooperation between APEC member states’ competition authorities.
6. Economic Costs and Benefits of Stronger Competition Policy in the APEC Region

This section provides a summary of the economic costs and benefits of competition policy within the APEC region. First, it provides a background of the influence of competition policy on APEC economies. Second, it establishes how competition relates to other factors such as output, pricing and innovation. Third, it presents the likely effects of increased competition policy and law in relation to both scope and enforcement. Fourth, it considers the effects of stronger competition at the APEC level, as well as for the Philippines.

Background

Competition represents a mixed blessing for the APEC member economies. Figure 24: A simple model of costs and benefits related to more competition in the APEC region shows the potential effects on APEC economies of increasing the scope and enforcement of competition policy and law. This depends on the effect of market competition on quantities produced and prices. When stronger competition simply shifts demand from one SME to another, or from a large domestic firm to an SME, there may be no significant reduction in costs.\(^\text{137}\) However, when competition spurs innovation leading to lower production costs, competition may render consumers better off.\(^\text{138}\) Such innovation increases quantities provided to consumers and either lowers prices, or increases prices to the extent that consumers get more value for their money given better quality goods or services.

Our competition scope and enforcement indicator comprises a core part of our analysis. Figure 25: Comparison of competition scope indicators among select APEC member economies\(^\text{25}\) shows the value of this new updated scope indicator for several APEC member economies.\(^\text{139}\) New Zealand has the “best” competition policy and law as measured by the extent of legal provisions covering competition related issues and enforcement. In contrast, the Philippines and Brunei come in at the bottom of this indicator. Past economic development in South East Asia relied on state planning and industrial policy with no focus on promoting market competition. In the current context, many APEC member economies must balance between establishing a

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\(^{137}\) Costs rise because these companies spend more on R&D, administration, management and so forth in the attempt to lure customers away from rivals and keep customers for themselves. Most economists know this as destructive competition.

\(^{138}\) Some cases still exist where innovation can immiserate an economy, such as when too many entrepreneurs chase too few ideas. For the specific parameters of this case, see Sameeksha Desai, Zoltan Acs, and Utz Weitzel, A model of destructive entrepreneurship, 34 World Institute for Development Economics Research Working Paper 4, 2010, available online.

\(^{139}\) We describe the methodology used in Appendix I.
rigorous competition regime and other national economic and development interests.\textsuperscript{140} For example, the length of time that Brunei authorities have taken to draft a competition law, and the extent of repetition of the Singapore law, suggests that market competition is unlikely a top priority.\textsuperscript{141}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{competition_scope_indicator.png}
\caption{Comparison of competition scope indicators among select APEC member economies} \textsuperscript{142}
\end{figure}

**How does competition relate to output, innovation and prices in the APEC region?**

Competition policy influences economic growth by making markets work more efficiently.\textsuperscript{143} Figure 26: Historical GDP nominal growth rates of the APEC member economies between 2011 and 2015 shows nominal GDP growth rates of the APEC member economies from 2011 to 2015. Economic growth as depicted represents the sum of the contributions of capital, labour, knowledge, public goods and competition policy and law. Figure 27: Correlation between exports (as a percentage of GDP) and the competition scope indicator shows the link more clearly with one element of output growth: exports. If SME growth follows the general trend, the relationship between competition and export performance seems to have three phases. For low levels of competition, more competition increases SME export growth. For middle levels of competition, SMEs’ export performance falls as the economy becomes more competitive. For very high levels of competition, SMEs’ export performance again increases. While these data do not account for outside factors, they still reveal a basic observation about competition and SME performance. At some stage of development, competition policy and law may temporarily hurt SME growth, requiring government to make the difficult decision of further pushing market competition in order to achieve longer-term SME expansion.

\textsuperscript{140} The exclusion of vertical anticompetitive agreements from Singapore’s competition law shows the enduring influence of the industrial policy mindset. See Cavinder Bull, Chong Kin Lim, and Scott Clements, A new era for competition law in the ASEAN region, Drew & Napier Thought Leadership Briefs, 2016, available online.

\textsuperscript{141} Id.

\textsuperscript{142} The competition scope indicator presented here has been calculated based on the value of overall competition, domestic competition and the effectiveness of the competition agency (World Economic Forum), the distance to the frontier statistics (World Bank), market power (Cherides et al., 2013) and Hylton and Deng’s (2007) competition scope index.

\textsuperscript{143} Few experts have tried to establish an empirical connection between competition law/policy and economic growth. Stephen Davies comes the closest with ways to conduct a cost/benefit assessment of a competition authority. See Stephen Davies, A survey of the approaches and methods used to assess the economic effects of a Competition Authority’s work, Swedish Competition Authority Working Paper 2012:1, 2012, available online.
If APEC economies aim to use competition policy and law to boost economic growth, such competition needs to add something to the production function not already present. Figure 26: Historical GDP nominal growth rates of the APEC member economies between 2011 and 2015

and other research reveals that increases in productivity represent the only sustainable way of growing over time. Competition alone will not make APEC member economies’ SMEs better off. Figure 28: Cross-country correlation between innovation and the competition scope indicator shows the relationship between the level of competition policy and law in APEC member economies and the extent of innovation. At first glance, higher levels of competition and innovation go hand-in-hand, as shown by the upward sloping line of best fit. However, as shown by the horizontal gray lines in the figure, numerous economies can have very different levels of competition corresponding with the same level of innovation. For example, several APEC member economies score approximately 60 on the innovation index, including one with a competition index score of around 45 and two with competition scores above 90. In addition to promoting market competition, efforts to encourage innovation may be necessary to further push economic growth and specifically SMEs’ growth. 

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144 Numerous other experts have found similar results. For one example, see Philippe Aghion, Nicholas Bloom, Richard Blundell, Rachel Griffith, Peter Howitt, Competition and Innovation: An Inverted U Relationship, NBER Working Paper No. 9269, 2002, available online.
The effect of market competition on prices can vary depending on the way that producers respond. Evidence shows that competition tends to lower prices while having little effect on innovation.\textsuperscript{145} While Figure 28 shows a positive relationship between innovation and competition, there are instances where a good and service quality deteriorates as competition intensifies.\textsuperscript{146,147}

The impact of competition on the prices of SMEs’ goods and services remains important. Figure 29: Relationship between inflation and competition based on 2013 data (World Bank, 2016) shows the relationship between inflation and competition, providing an illustration of results from the broader literature. High level of competition is associated with price decreases, and thus higher consumer welfare.

Likely effects of competition and enforcement

SMEs in the largest APEC member economies have the most to gain from encouraging local and cross-border competition. Error! Reference source not found.\textsuperscript{30} shows the estimated benefits to SMEs comparable across countries, in output terms and expressed in US dollars. SMEs from China, the USA and Korea represent the largest potential winners in absolute terms.\textsuperscript{148} Given the

\begin{itemize}
\item \textsuperscript{145} Busso and Galiani show their own results, as well as provide other literature in this area. See Matias Busso, Sebastian Galiani, The Causal Effect of Competition on Prices and Quality: Evidence from a Field Experiment, NBER Working Paper No. 20054, 2014, available online.
\item \textsuperscript{146} Inelastic means they take the price increase without balking. See Saul Lach and Jose-Luis Moraga-Gonzalez, The Asymmetric Price Effects of Competition, CEPR Discussion Paper No. DP7319, 2009, available online.
\item \textsuperscript{147} A number of studies find such a deterioration in quality. For one example, see Julien Forder, and Stephen Allan, The impact of competition on quality and prices in the English care homes market, 34 Journal of Health Economics 4, 2014, available online.
\item \textsuperscript{148} We do not express these gains as a percent of GDP or other relevant indicator (like government spending), as such gains represent only a fraction of these values. Moreover, policymakers have the tendency to consider dollar amounts when comparing policies.
\end{itemize}
large existing production base in these countries, extra competition helps SMEs integrate more in local supply chains and business systems. In the Philippines and Russia, there is not the same strong base of productive capacity upon which SMEs can grow. Among developing country members, SMEs from Indonesia and Mexico have the most to gain. On average, Indonesian SMEs have twice the productivity of Malaysian SMEs. Several studies suggest that potential gains from competition could be much higher if SMEs focus on foreign markets. Similarly, Mexico’s SMEs typically experience double the gains than those in Russia, but benefits from competition would have been higher without the cash constraints SMEs face.

The benefits of competition can vary among different APEC member economies, depending on the circumstances of the particular economy. Figure 31: Comparison of estimated benefits to SMEs based on a one point increase in the scope of competition policy and law among other select APEC member economies shows the estimated relative benefits of increased competition in selected APEC member economies’ SMEs. This figure is based on author’s analysis aligned with Figure 24. In terms of the diversity of impacts increased competition could have, Vietnamese SMEs represent one of the largest beneficiaries of competition and would benefit even more if productivity improved. Hong Kong’s SMEs compete in a small local economy and face competition from a range of companies including importers, and with many more once integration with the Mainland proceeds. Brunei’s existing business practices affecting SMEs would likely carry on for a long time after the implementation of its competition law. Japanese SMEs would likely face short term challenges given this will likely result in the removal of years

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149 Similarly to the World Bank study we critiqued earlier, The Philippines continues to come out at the bottom of the ranking.
154 See Ng Ying-chu, Vivienne Luk and Kang Liew Inn-lee, The Road to Sustainable Development of Hong Kong SMEs - The Present and Future, 2011, available online.
of government protection and support. APEC member economies need to evaluate the necessity to provide assistance to SMEs harmed by competition, and align multilateral efforts to promote competition in the region.

![Figure 31: Comparison of estimated benefits to SMEs based on a one point increase in the scope of competition policy and law among other select APEC member economies (author’s analysis, based on approach outlined in Figure 24)](image)

There are a number of changes that would occur if policies designed to improve SMEs’ innovation and productivity worked concurrently with the implementation of competition policy and law. Figure 32: Potential harm to SMEs in APEC member economies with lagging innovation policies and practices (Reynoso et al., 2016) illustrates the harm to SMEs in APEC member economies with lagging innovation policies and practices. The figure shows that innovation and competition interact, with larger values representing the combined negative impact of competition, low productivity, and lack of innovation. Even in a highly developed economy like Japan, incremental competition does not automatically benefit SMEs given the dominance of massive financial and industrial groups.

![Figure 32: Potential harm to SMEs in APEC member economies with lagging innovation policies and practices (Reynoso et al., 2016)](image)

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156 See Maurice Stucke, Is competition always good?, 1 Journal of Antitrust Enforcement 1, 2013, available online.


Summary
The final section of this report has provided an outline of the economic costs and benefits of stronger competition policy in the APEC region. As shown, while competition policy influences economic growth by making markets work more efficiently, increased competition policy alone will not make APEC member economies, or their SMEs, better off. Increased competition needs to be complemented by actions to improve productivity and promote innovation among the SME sector to reach the desired benefits. Simply shifting demand from one SME to another, or from a large domestic firm to an SME, is unlikely to reduce prices paid by consumers or improve the quality of products. Competition benefits will be more likely achieved if productivity and innovation can lead to increased quality of goods or services, at a lower cost to consumers.

Increased competition has the potential to bring variable results for different APEC member economies, particularly over the short term. Greater levels of competition from exposure to imports may result in decreased short-term SMEs’ performance while they transition towards higher levels of productivity. The degree to which this occurs will be dependent on factors specific to the economy, including the degree to which government has historically provided support and protection to SMEs. During this stage where increased competition may temporarily hurt SME growth, governments will need to balance the short-term difficulties in order to achieve longer-term SME expansion. As shown above, these considerations will need to be made on an economy by economy basis.
Appendix I: Mathematics and Statistics

We employ an accepted model of competition and growth in order to arrive at our estimates. Specifically, Baldwin and Robert-Nicoud derive a model in which economic growth depends on innovation and competition.\(^{159}\) Equation (1) shows their specification of a firm’s market share (as a function of its marginal costs).\(^ {160}\) In that equation, \(m\) represents marginal costs, \(n\) represents the value of firms, \(E[m]\) represents a weighted average of these marginal costs. Furthermore, \(a\) represents sales of the firms’ differentiated products and \(G[a|a_D]\) represents the probability distribution of sales for these firms. The parameter \(\phi\) represents the level of trade freeness (with \(\tau=\infty\) for a closed economy and \(\tau=1\) for a perfectly open one). Equation (2) shows the standard utility curve in this model. In this equation, \(r\) represents the value of consuming something today rather than later, \(D\) represents the consumption basket of all SME’s (or firms) products, \(d_i\) represents the consumption of SME’s i good or service. The rest of the parameters look more familiar — with \(Y\) equating to income, \(E\) to expenditure, \(S\) as saving/investment, \(L\) as labour income, \(E/\sigma\) represents profits and capital \(\theta\) represents the actual set of SME goods consumed. These equations yield the growth condition and SME production as shown in equation (3). In that equation, \(K\) represents the value of new, innovative products, capital \(\Omega\) represents production, \(T\) represents growth of output (defined as the inverse function of the stock of innovations \(K\)) depends on the scale of innovation, whether such innovation goes to the domestic or export sector, and the level of competition in the economy.

\[
\Delta = \frac{L/\sigma}{p_kE[K]} \frac{\rho(\sigma-1)}{\sigma} \left( \frac{(1+\Omega) K_X}{\Omega(1-\Omega) D} \right)^{1/k} \quad \text{or} \quad \frac{L/\sigma}{\rho_k[E[y^{-1}(K)]]} \frac{\rho(\sigma-1)}{\sigma} \left( \frac{(1+\Omega) y^{-1}(K_X)}{\Omega(1-\Omega) y^{-1}(K_D)} \right)^{1/k}
\]


\(^{160}\) We use the same variable and parameters as the original authors, to make clear that these equations belong to them.
Prices, competition and innovation relate to each other as follows. Adding prices to the equation and making exported goods and domestic goods equal to each other, we see at its optimal – and after replacing our competition indicator with its relation to innovation – that output equals the root of a bunch of terms (including our indicators for competition and innovation). In this model, prices will always fall as GDP rises (mainly because we model preferences rather than profits). If we further assume that innovative capacity is normally distributed across countries, we see that some countries’ GDPs’ can increase with more competition and innovation. Yet, depending on the value of beta and k, such growth could easily be negative. Moreover, remarkably, the size of this harm or benefit depends on the size of competition, innovation and the already existing growth rate.

\[
\Delta Y = \frac{L/\sigma}{p_k p \cdot E[y(K)]} \rho(\sigma - 1) \left( \frac{(1 + \Omega)}{\Omega(1 - \Omega)} \right)^{1/k} \quad \text{or} \quad \frac{d\Delta Y}{dK} = -\frac{L/\sigma}{p_k p \cdot y^2} \rho(\sigma - 1) \left( \frac{(1 + \Omega)}{\Omega(1 - \Omega)} \right)^{1/k}
\]

\[
\frac{d\Delta Y}{d\Omega} = -\frac{1}{k} \frac{L/\sigma}{p_k p \cdot y^2} \frac{\rho(\sigma - 1)}{\sigma} \left( \frac{(1 + \Omega)}{\Omega(1 - \Omega)} \right)^{(1-k)/k} \left(2\Omega^2 + 2\Omega - 1 + \frac{(\Omega^2 - \Omega)}{(1 - 2\Omega)} \right)^{(1-2k)/k}.
\]

\[
\text{L} \rho(\sigma - 1) = -y^2kpp_k \sigma^2 \left( 2\Omega^2 + 2\Omega - 1 + \frac{(\Omega^3 - \Omega)}{(1 - 2\Omega)} \right)^{(1+\omega)/2} \left( \frac{(1 + \Omega)}{\Omega(1 - \Omega)} \right)^{\omega/(1-2k)/k}, \quad \Omega = \phi(K_x / K_D)^k/(\sigma-1)
\]

\[
\frac{L}{y^2} = -\frac{kpp_k \sigma^2}{\rho(\sigma - 1)} \left( 2\phi^0 + 2\phi - 1 + \frac{(\phi^0 - \phi)}{(1 - 2\phi)} \right)^{\beta} \left( \frac{(1 + \phi)}{\phi(1 - \phi)} \right)^{\beta/(1-k)/k}
\]

\[
y = \frac{-\rho(\sigma - 1)}{kpp_k \sigma^2} \left( 2\phi^0 + 2\phi - 1 + \frac{(\phi^0 - \phi)}{(1 - 2\phi)} \right)^{\beta - 1} \left( \frac{(1 + \phi)}{\phi(1 - \phi)} \right)^{\beta/(1-k)/k}
\]

With these relations in mind, we can easily derive both the competition scope indicator and the innovation penalty/bonus indicators. Instead of omega, we use several measures of the scope and enforcement of competition (as indicated in equation 10 by \( o_i \)). Following equation (9), we know that competition determines the change in GDP by some amount. We can thus take the “distance” of these various competition indicators using the Pythagoras theorem. Depending on the value of k and sigma, we can easily see that innovativeness increases with competition – and only increases due to investments in innovation for very small values of k less than one or sigma much larger than one. In other words, competition leads to innovation (and thus growth) if investments in innovation transfer to output faster than companies’ marginal costs decrease production/sales.

\[
\Omega = \left( o_1^k + o_1^k + o_1^k + \ldots + o_1^k \right)^{1/k} \quad \text{such that} \quad \Delta Y = \sqrt{\phi \Omega K^{k/(\sigma-1)}}
\]

\[
G(\phi \mid \Phi, \sigma) = \frac{1}{\sqrt{2\sigma^2}} e^{-(\phi - \Phi)^2} 2\sigma^2 K^{k/(\sigma-1)}
\]

Readers interested in distributional issues (between foreign and domestic companies or between foreign and domestic can use the original formulas.