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POLICY NOTE 1

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GOVERNMENT RESTRICTIONS OF COMPETITION FOR SMALL AND MEDIUM ENTERPRISES

The Philippine Competition Commission (PCC) was created under the Philippine Competition Act (PCA). The PCA, or the Republic Act No. 10667, was enacted in July 2015 providing a basis for improving competition practice in the Philippines. The PCC is mandated to conduct inquiries, investigate cases involving anti-competitive agreements, abuse of dominant positions, and anti-competitive mergers and acquisitions. It is also within their remit to impose administrative sanctions for violation of the PCA and engage in competition advocacy.

This Policy Note is based on work completed under the *Capacity Building for Small and Medium Enterprises (SMEs) on Competition Policy and Law (CPL)* project sponsored by Asia-Pacific Economic Cooperation (APEC). The analysis is based on a literature review and focus group discussions (FGDs) conducted with government agencies and regulators, SME representative associations, and selected SME business owners. The opinions here are those of the authors and do not necessarily represent those of the PCC.

Overview of SMEs and CPL in the Philippines

The Small and Medium Enterprises (SME) sector is a vital engine of poverty reduction and economic growth in the Philippines. In 2015, the SME svector contributed 35%[1] of GDP and approximately 62% of all jobs in the Philippines.[2]

Consequently, government policy emphasizes support for the SME sector. Table 1 outlines a number of relevant pieces of legislation to SME development in the Philippines.

There have been a number of successful initiatives in assisting SMEs, including the establishment of the Small Business Guarantee and Finance Corporation to provide finance, information, training and marketing services to local SMEs.

However, some government procedures inhibit small and micro businesses being easily established and becoming operational. Moreover, the government-imposed licensing requirements and the taxation system are cumbersome, inefficient, and frequently subject to corrupt practices. Other practices are government restrictions that limit competition in the SME sector and partially negate other pro-SME policies. Negative government restrictions stunt the SME sector, impair competition, and are a detriment to consumer welfare.

Addressing competition-related issues in the Philippines has been integrated into the Philippine Development Plan (PDP) 2017-2022. The chapter "Leveling the Playing Field through a National Competition Policy"

Table 1 – Legislation related to SME development

Reference	Summary
Republic Act No. 6977 (1991)	Magna Carta for Small Enterprises Policy statement recognising the importance of SME growth
Republic Act No. 9501 (2008)	Magna Carta for MSMEs Amends previous Act and recognises the broader class of micro-enterprises.
MSMED Plan 2011-2016	Six-year Micro, Small and Medium Enterprises Development Plan

[1] Mercurio, R. (2015). SMEs eyed to hike GDP contribution, The Philippine Star. Available at: http://www.philstar.com/business/2015/11/24/1525141/smes-eyed-hike-gdp-contribution
[2] Government of Philippines, The Department of Trade and Industry, 2015 MSME Statistics. Available at: http://www.dti.gov.ph/dti/index.php/2014-04-02-03-40-26/news-room/179-workshop-on-market-access-for-smes-set

outlines a number of key issues within the Philippines and presents a strategic framework for developing a National Competition Policy.

Specifically, it notes the importance of providing a market environment that is cognizant of SME needs: "Competition will create a level playing field for SMEs by removing barriers to entry and reducing costs so that they can actively participate in the market."[3]

Doing Business in the Philippines

Without competition, any market will produce sub-optimal results in terms of new business formation, business growth, employment and consumer choice. Where the market is not subject to barriers to entry, new SMEs are able to enter the market easily. If they are efficient and satisfy consumer demand, they will flourish and enjoy all the benefits of an efficient market. These benefits include growing GDP, providing employment, and assisting in poverty reduction. Where businesses are easy to create legally, the shadow economy shrinks and has the added benefit of increasing the economy's taxable capacity, thereby raising additional revenue without increasing tax rates.

There are well established competition-related issues affecting the economy of the Philippines. The Global Competitive Index produced by the World Economic Forum provides a basis for comparing the competitiveness of 138 economies. In the 2016-2017 report,[4] the Philippines was ranked 57th, having dropped 10 places from an overall rank of 47th based on the 2014-2015 report. The Philippines' poorest performance was in relation to goods market efficiency (99), infrastructure (95) and institutions (91).

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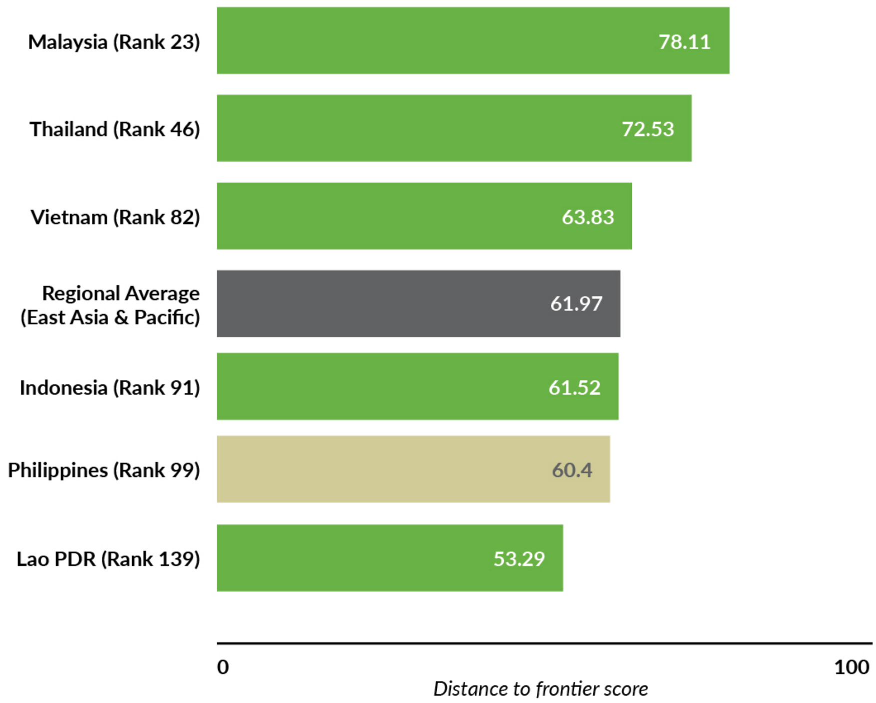
Figure 1 – Comparison of ease of doing business in selected economies[5]



[3] Government of Philippines, National Economic and Development Authority, (2017). Philippine Development Plan 2017-2022. p.249
[4] The World Economic Forum, (2017). The Global Competitiveness Report 2016-17. Available at: https://www.weforum.org/reports/the-global-competitiveness-report-2016-2017-1
[5] The World Bank, (2017). Doing Business – the Philippines Profile. Available at: http://www.doingbusiness.org/~/media/wbg/doingbusiness/documents/profiles/country/phl.pdf. p.8

It is also well established that there are challenges for the conduct of business in the Philippines, particularly for SMEs. The World Bank's Doing Business provides a broad assessment of the ease of doing business across 190 countries.

Figure 1 provides a comparison among selected economies in relation to the Doing Business Index. In 2017, the Philippines ranked 99th on this index, performing particularly poorly in starting a business (171), protecting minority investors (137), enforcing contracts (136), getting credit (118), and paying taxes (115).[6] These same factors are identified in the Global Competitiveness Index as inhibiting business, primarily including inefficient government bureaucracy, inadequate infrastructure, corruption, tax rates, and tax regulations.

The PDP 2017-2022 acknowledges the existence of many of these issues, particularly those that emerge from government policy and regulation, and have integrated ways of addressing them into the proposed strategic framework.

The factors identified above have emerged as key issues of concern through the conduct of the current project, specifically in relation to barriers for SMEs doing business. A number of the key areas that emerged are discussed below.

Government restrictions to SME market engagement

There are multiple competition-related factors that restrict the market engagement of SMEs.

Business registration

Difficulty in business registration was identified as a key issue for SMEs in the Philippines. In the 2017 Doing Business assessment, the Philippines is ranked 171st in the Starting a Business measure. This assessment noted that registering a business in the Philippines was a 16-step procedure that takes approximately 28 days to complete. This covers basic registration requirements, which includes registration as a corporation with the Securities and Exchange Commission (SEC), as a taxpayer with the Bureau of Internal Revenue (BIR), and with the social agencies (such as the Social Security System, Philippine Health Insurance Corporation, and Home Development Mutual Fund), as an employer and securing initial business permits and clearances with the local government, where the enterprise is located.[7]

FGD participants confirmed that this was a key issue for them. SME participants, particularly the province-based entrepreneurs, noted that the registration requirements were complicated and time consuming, especially with respect to the BIR and the local government units (LGUs). While the sample of SMEs engaged

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[6] The World Bank, (2017). Doing Business – the Philippines. Available at: http://www.doingbusiness.org/data/exploreeconomies/philippines
[7] While partnerships and sole proprietorships are not covered by the Doing Business Reports, the registration requirements for these enterprises (except registering as a business) are the same as that of a corporation.

Case Study: BIR Taxes and Compliance Procedures

After registering the business with either the Securities and Exchange Commission (SEC), or the Department of Trade and Industry (DTI), a typical SME will need to register as a taxpayer with the Bureau of Internal Revenue (BIR). This requires filing an application for registration with the BIR, applying for an Authority to Print (ATP) official receipts or sales invoices with the BIR, having these receipts or invoices printed by an accredited BIR printer, having books of accounts stamped by the BIR or going through the process of getting BIR approval for its computerized accounting system.

After securing the BIR registration, the SME is required to comply with all the tax and regulatory requirements imposed by law and regulations. A typical SME, not enjoying fiscal incentives, is usually subject to the following taxes: (a) income tax of either 30% (for corporations and partnerships) or graduated rates ranging between 5% and 32% (for a single proprietor); (b) percentage tax of 3% (when gross revenues amount to PhP1.919M or less); (c) Value-Added Tax of 12% (when gross revenues exceed PhP1.919M); (d) expanded withholding tax for certain suppliers; and (e) withholding tax on employee compensation. All these taxes require that the SME periodically files reports with the BIR on a monthly, quarterly and/or annual basis, regardless of whether taxes are due or not during a particular period. This places an additional administrative burden to an SME, especially a start-up.

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indicated a willingness to comply with these registration requirements, the lack of one source of information, or the failure of government to properly communicate these to first-time entrepreneurs, makes compliance more challenging and exposes them to unnecessary fines and penalties.

Some recent improvements have been made with certain parts of the registration now possible online. However, it was noted that multiple registration processes, which can be accessed from and processed through varied sources, still exist.

Taxes

Problems were reported in relation to both complicated processes to pay tax and the amount of tax paid. In the 2017 Doing Business assessment, the Philippines is ranked 115th in relation to the Paying Taxes measure. SME owners and SME Association representatives noted that tax compliance procedures are burdensome to SMEs, especially start-ups.

Government representatives confirmed this.

The FGD participants reported that there are multiple taxes and fees that businesses are required to pay. These include income tax, percentage tax, Value-Added Tax (VAT), local taxes and fees that vary across LGUs, tax and duties on the entry of goods into the country, excise taxes and others that are industry-specific. The complexities of compliance processes are outlined in the Case Study box.

Table 2 – Total tax rate (% of profit) among selected economies in 2017[8]

Economy	Total tax rate (% of Profit)
Philippines	42.9
Indonesia	30.6
Lao PDR	26.6
Malaysia	40.0
Vietnam	39.4
Thailand	32.6
Best performer globally	26.1

Table 2 highlights that the total tax rate in the Philippines, as a percentage of profit, is high when compared to other regional economies.

The challenges associated with navigating taxation are a disincentive for businesses. As one SME owner expressed although they wanted to register in the Philippines, "it just did not make financial sense". This led them to establish their business in Singapore instead.

Licensing and permits

Secondary registrations and licensing[9] were identified as equally challenging to taxation procedures. For first-time registrants, especially those who are province-based, information on these secondary licenses are not easily accessible, given their limited access to the Internet, or Internet literacy. Participants noted they start their business with very little or no knowledge of these requirements which they find out when they expand their operations. This makes the expansion process more burdensome.

First-time registrants in the food industry with the FGDs noted that permits and licencing are particularly burdensome as they require significant work. These include a license to operate, hygiene, health, physical structure, Certificate of Product Registration and traceability for safe issues. This level of burden was increased in relation to transport of goods across LGUs, with SME incurring costs for moving goods through different jurisdictional boundaries.

Regulatory burden and overlapping mandates

The PDP 2017-2022 chapter on competition policy recognizes that overlapping mandates, policies and regulations are problematic in the Philippines.

Participants across government, SME associations and SME owners confirmed, noting that the burdens of administrative systems are proportionally far greater for SMEs than big businesses. This is both in relation to registering and

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[8] The World Bank, (2017). Doing Business – the Philippines Profile. Available at: http://www.doingbusiness.org/~/media/wbg/doingbusiness/documents/profiles/country/phl.pdf . p.14
[9] These are industry-specific registrations for industries or products that have special regulatory requirements, pursuant to existing State policies.

running a business.

For example, an FGD participant engaged in a social enterprise noted various challenges in the entry and innovation of SMEs in biotech industries. While they had access to materials, the necessary skill sets or technology to support product development, the burden from government regulations and requirements were significant barriers to entry.

Overlapping mandates for government agencies was a current key source of impediment to SME engagement in the formal sector. This was noted at the national level, as well as with LGUs. Investigating this issue would be a focus for the Competition Audit proposed below.

Local government units

LGUs provide further complications and restrictions to administrative and fee-based burden of SMEs establishing and running a business. FGD participants noted that the administrative processes at a LGU level could be burdensome and expensive. As government entities have relative autonomy from the national government, LGUs are allowed to raise their own sources of revenues in addition to the Internal Revenue Allotments (IRA) provided by the national government. The taxes, fees and charges that these LGUs may impose vary and depend on their respective classification (whether barangay, municipality, city or province). For certain fees and charges, LGUs are given some discretion in setting the amounts charged and collected.

Participants contended that to raise more revenues, some LGUs charge and collect other fees and charges in addition to the business taxes imposed, putting additional financial burden on SMEs.

Participants noted further issues in relation to the costs and transporting goods within and across LGUs and issues related to zoning and a preference for big investors rather than facilitating SME access to markets. Several SME owners reported instances of corrupt and fraudulent practices, for example in securing an assurance that permits would be approved.

Challenges to government

A challenge for government agencies in promoting the growth of SMEs relates to the availability of reliable data for monitoring and evaluation purposes. The lack of quality data impedes the formulation of targeted policies for SME development. As noted in FGDs, the government provides numerous support services to SMEs through various departments and programs.

However, in addition to a failure to communicate these programs to stakeholders, government agencies do not have access to reliable data that will help them assess

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the impact of these support services. Data gathering and processing capabilities, not only of the Philippine Statistics Authority, but also the statistics offices of the various government agencies, must be strengthened.

Conclusion and recommendations

There are a great number of benefits that could be achieved through addressing the problems identified in this policy note and by reducing the government based restrictions on SMEs. Simplifying the registration procedures and costs could allow for a greater number of businesses registering in the formal market, potentially increasing government revenue from the formal economy and resulting in less businesses registering overseas. Better coordination between key government agencies is important in achieving these benefits.

At a whole-of-government level, improvements could be achieved through a number of specific activities. These include:

- Streamline the business registration process. This could include the removal of local registration requirements and provision of substitute revenue for local government by national government grant in return for this change. Such a strategy was successful in Australia in the 1990s as a result of the Hilmer Report[10] that allowed the removal of state-level imposts and regulations resulting in enhanced economic efficiency and competition.

- Investigate the differentiation of administrative and regulatory burden for SMEs compared to large businesses

- Simplify the taxation system, particularly processes related to fees and permits.

While the implementation of activities to directly address the problems are beyond the remit of the PCC, it can play an important role.

We recommend that the PCC lead in undertaking a Competition Audit of Government Agencies' policies and practices. This would aim to identify efficiency issues as a result of the large number of government agencies, at different levels, with overlapping mandates and to propose consolidation, and abolition or reform of structure and processes as appropriate. If undertaken on a whole-of-government basis, this would provide potential intervention points to most effectively reduce government restrictions. This is a vital prerequisite to increasing market participation for SMEs and to enhance competition and economic growth.

We recommend that the PCC

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[10] Government of Australia, Independent Committee of Inquiry, (1993). National Competition Policy.

continue to lead in advocating for the reduction of 'red-tape' that limits the involvement of SMEs in the market, and the 'buy-out' of local government business registration and licencing. For example, this could include supporting tax reform measures of the Department of Finance.

We also recommend that the PCC continue to build collaborative alliances with different government agencies and input into their activities, where appropriate. For example, this could include coordination with the National Competitiveness Council and the annual survey to assess the compliance of local government units with national mandated standards.

To address the data challenges of implementing government agencies, in addition to strengthening the Philippine Statistics Authority, national and local government should maximize the use of information and communications technology, enhance data-sharing across government agencies and establish systems that facilitate inter-operability among agencies performing related functions.

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Prof. Mark Williams has been working in competition law and policy for 25 years. He has taught competition law for over 20 years in Hong Kong, China, and numerous other Asian countries before taking up an appointment as a Professor of Law at th University of Melbourne in 2014. He established the Asian Competition Forum in 2005 and has worked extensively with ASEAN, APEC, UNCTAD and many Asian competition agencies on various competition policy and law assignments. He has written several books and published numerous articles and book chapters on competition law including on SME competition issues in ASEAN and Hong Kong.

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