

INFRASTRUCTURE, COMPETITION, AND 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.

The intersection of infrastructure, competition and SMEs

Infrastructure issues have been identified as limits to doing business in the Philippines. On an international level, the Philippines' poor performance in relation to infrastructure has been identified as a key issue undermining the country's competitiveness.

The Global Competitiveness Index, published by the World Economic Forum, provides an international comparison of policies, institutions and other factors which influence the competitiveness of a country's economy. In the 2016-2017 Index, the Philippines was ranked a respectable 57 of 140 countries on an overall basis. However, in relation to infrastructure the performance was poorer with a rank of 95.¹

The World Bank's Doing Business assessment also noted that inadequate infrastructure in the Philippines was the second most significant problem in conducting business in the Philippines, behind inefficient government bureaucracy and preceding corruption.²

The interaction among infrastructure, access to finance and Small and Medium Enterprises (SMEs), and its relationship to competition, is multifaceted.

First, inadequate infrastructure can limit the ability for SMEs to engage in markets. This includes restricting access to finance, road, transport and shipping, telecommunications and connectivity, and utilities.

Second, anti-competitive processes that occur in the development of infrastructure can disadvantage SMEs and society by inflating infrastructure costs or marginalizing SME suppliers on non-efficiency grounds. Specifically, there is ample evidence that there is a problematic nexus in many Asian

economies between bid-rigging³ in public procurement contracts, especially in the construction sector, and corrupt payments to officials. For example, Japan and Indonesia have seen many such cases with 56-80 percent of the Indonesian KPPU⁴ case load in 2000-2014 being procurement bid-rigging cases.⁵

These issues are of significant relevance in 2017 given the recent announcement of large public infrastructure investment in the coming years in the Philippines.⁶

Infrastructure issues that limit SMEs market access

While lack of infrastructure is not directly a competition issue, it is a factor that limits competition, particularly for SMEs. It is an issue that needs to be addressed if the intent as outlined in the Philippine Development Plan (PDP) 2017-2022 is to be achieved: "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."⁷ Without it, SMEs will continue to be competitively disadvantaged when it comes to facilities, technology, and infrastructure.

The following are key infrastructure problems that restrict SMEs.

Access to finance

Adequate access to finance is an issue for SMEs in the Philippines. The FGD participants noted that access to banking facilities is problematic. The Bangko Sentral ng Pilipinas (BSP) estimates that about 86 percent of Philippine households are 'unbanked' or do not have any bank accounts.⁸ This is a particular problem in rural settings, especially with tenant farmers, who cannot provide collateral for bank loans as they are not owners of the land they till. Even if they own their farms, problems in property registrations may also prevent them from using these

¹The World Economic Forum, (2017). The Global Competitiveness Report 2016-17. Available at: <https://www.weforum.org/reports/the-global-competitiveness-report-2016-2017-1>

²The World Bank, (2017). Doing Business – the Philippines Profile. Available at: <http://www.doingbusiness.org/~media/wbg/doingbusiness/documents/profiles/country/phl.pdf>.

³Bid-rigging is a form of fraud in which a commercial contract is promised to one party, even though several other parties also present a bid for the sake of appearance.

⁴Komisi Pengawas Persaingan Usaha, the Indonesian Competition Authority

⁵OECD, (2014). Annual Report on Competition Policy Developments in Indonesia. OECD Competition Committee, 20 October 2015.

⁶Department of Finance, Government of the Philippines, (2017). "64 major projects underway in 'golden age of infrastructure'" 26 January 2017. Available at: <http://www.dof.gov.ph/index.php/64-major-projects-underway-in-golden-age-of-infrastructure/>

⁷Government of Philippines, National Economic and Development Authority, (2017). Philippine Development Plan 2017-2022. p.249

⁸Chipongian, Lee, (2017). "86% of Filipino households do not have bank accounts –BSP survey," Manila Bulletin, January 14, 2017. Available at <http://business.mb.com.ph/2017/01/14/86-of-filipino-households-dont-have-bank-accounts-bsp-survey/>. Accessed July 13, 2017.

farms as collateral.⁹

In addition, farmers generally have limited financial literacy, which leaves them ill-equipped to manage the risks associated with taking out loans from formal financial institutions.

With limited access to financing, farmers are unable to secure capital to fund the improvement of their farming facilities and acquire better farming technology. The majority of Philippine farmers, thus, continue to practice traditional farming methods that limit their productivity and prevent them from scaling up production.

A significant problem for SMEs accessing funding, as noted above, is that banks are collateral-focused. Lands acquired under free patent or homestead cannot be sold or mortgaged within 5 years from the issuance of the patent. Also, lands acquired under the agrarian reform program cannot be sold within 10 years from the date of the award. This limits the ability of landowners, acquiring these lands to either mortgage or sell the same, to finance any business venture. While some banks have pro-SME policies, the SMEs cannot take advantage of them as they do not have collateral that is acceptable to the banks to secure the loans. FGD participants noted that, as a consequence, SMEs tend to turn to loan sharks or rely on family members for financing, or access funds from small financial institutions that specialize in the micro-lending space but with very high monthly interest rates. This presents significant barriers to business formation and expansion, particularly in rural areas.

Roads, transport, and shipping

Lack of adequate transportation-related infrastructure provides clear limits for SMEs, particularly in being able to access new markets. This presented particularly acute issues to rural industries for market accessibility. Inadequate transport infrastructure adds significant costs to SMEs in relation to transit time, financial cost and potential spoilage.

The FGDs reported issues with the provision of road transport services in the Philippines. Specifically, participants observed that much of the road haulage industry is cartelized,¹⁰ with uniform fee structures and absence of competition in the sector co-ordinated by the road haulers association.

Shipping transport was also identified as being problematic. Participants reported that shipping costs within the Philippines are significant and can be more expensive than export shipping costs. Monopolization or cartelization of routes and freight rates was also noted during the FGDs.

Telecommunication and connectivity

FGD participants noted that there are too few players in the telecommunications sector. The result of this is high costs and poor service quality due to a lack of competitive activity to provide better service and to invest in telecommunications infrastructure; deficient industry regulation may also be a cause of market failure.

Internet connectivity is inconsistent and unreliable. Broadband speed in the Philippines is one of the slowest in the Asia Pacific region.¹¹ One SME owner noted that they were required to maintain two contracted service providers in order to ensure 'back up' in case of service failure by one of the providers, doubling the cost of internet access.

Utilities

As reflected in the 2017 World Bank Doing Business assessment, the Philippines performs well for access to electricity, ranked 22 of 190 countries. This was an improvement from its rank of 30 in the 2016 assessment. Overall, FGD participants confirmed that access to utilities was adequate in the Philippines, with some connectivity issues in the Southern Philippines. However, the cost of utilities, specifically electricity, was noted by FGD participants as a limiting factor in their growth.

A lack of competition in the electricity market has caused prices to be significantly higher than in comparable countries in the Association of Southeast Asian Nations region. This has been a particular disadvantage in the manufacturing sector, which is a large consumer of electricity. This was confirmed by a number of SME owners and SME associations.

“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.”

⁹Elauria, Marilyn M., (2015). “Farm Land Policy and Financing Program for Young Generation in the Philippines,” FFTC Agricultural Policy Articles. Available at http://ap.fttc.agnet.org/ap_db.php?id=448&print=1.

¹⁰A cartel is an association of manufacturers or suppliers with the purpose of maintaining prices at a high level and restricting competition

¹¹Inquirer, July 5, 2016. Available at <http://technology.inquirer.net/49120/philippine-internet-speed-slowest-improvement-southeast-asia-akamai-report>. Accessed July 17, 2017.

Bid-rigging and public procurement

In developing economies, bid-rigging related to construction and public procurement is very common. The new commitment of the Government of the Philippines to increase physical infrastructure spending, to help rectify an identified barrier to economic growth, is commendable.

However, as such large sums are to be expended in public procurement, the risk of collusive bidding is high given that current law effectively prevents foreign construction companies from easily entering the market.

Furthermore, the risk of procurement officials facilitating bid-rigging, in return for corrupt 'kick-back', is very high.

Unless these risks are understood, and the Philippine Competition Commission and the anti-corruption agency coordinate their activities, very substantial losses to taxpayers are likely to be incurred by inflated project costs caused by uncompetitive prices and a 'corruption surcharge' that will be added to legitimate project costs.

Conclusions and recommendations

There are a range of benefits to be gained from improving the provision of infrastructure in the Philippines and ensuring that bid-rigging activities are prevented.

Many of these possible actions are beyond the direct scope of the PCC. However, we recommend that they be integrated into the overall advocacy strategy for the PCC in leveling the playing field.

Greater access to finance by adjusting banks' lending practices could provide a stimulus to the SME sector, reduce 'rent seeking' by loan sharks, and improve SME profitability.

This initiative would have to be coordinated with other government agencies and the central bank, and be included in amendments to government restrictions of competition (see Policy Note 1: Government Restrictions of Competition for SMEs).

SMEs, especially agriculture-based SMEs, would greatly benefit from government support and assistance in improving their financial literacy.

Enforcing measures related to bid-rigging in public procurement and infrastructure projects will bring significant benefits in opening the process to greater competition. We recommend that a multifaceted approach be taken in ensuring enforcement. At a basic level, this would include the provision of information to infrastructure firms and construction companies on the prohibition of bid-rigging, and the civil and criminal penalties applicable. The PCC could also advocate under their leniency system, the encouragement of whistle blowers to provide evidence of secret bidding rings. This would require coordination with the Department of Justice (DoJ) for civil and criminal leniency and with the anti-corruption agencies, such as the Ombudsman, to coordinate enforcement actions to prevent procedural duplication. Actions could be taken to promote opportunities for more players in the market by considering tender qualification requirements and allowing foreign firms access to the infrastructure procurement market.

Sector-specific recommendations

In addition to the above, there are opportunities for addressing issues within the specific sectors of transport, telecommunications, and utilities.

Transportation

On the part of the PCC, allegations of cartel and monopolistic behavior in the trucking and shipping industries should be further investigated, and the specific anti-competitive behavior should be identified.

Given the low level of public awareness of the PCA and its consequences, the PCC may initially use the result of its investigation to draft targeted regulations to guide the behavior of market players. The PCC should also conduct advocacy campaigns to inform the public of these rules. It can then proceed to take enforcement actions should the anti-competitive behavior of market players persist.

Moreover the PCC may examine the structure of the transportation industry and identify bottlenecks to users, as well as to industry players, across the supply chain. The objective would be to determine whether existing laws and regulations affecting the industry stifle competition, or whether a lack of sufficient regulations allow dominant

“The provision of better infrastructure will result in greater market efficiency for the conduct of business. Specifically, it will assist with promoting access to markets for SMEs including allowing more competitors into any given market.”

players to abuse their position in the market.

On the part of the government, in general, it should engage in a coordinated effort across agencies to improve port, road and rail infrastructure, as well as facilities supporting logistics services.

Telecommunications

As of this writing, the PCC's review of the acquisition by the Philippine Long Distance Telephone (PLDT) Company and Globe Telecom (Globe) of San Miguel Corporation's telecommunications assets is the subject of pending cases before the courts. Regardless of the outcome, the PCC should continue monitoring the conduct of large market players for any indication of anti-competitive behavior and take the appropriate enforcement action.

The PCC could further investigate, if warranted, possible abuse of dominance in the mobile telecommunications sector and lobby for the formulation of policies that would encourage the entry of new players.

Utilities

A recent industry study indicated that, at least in Luzon, average tariffs have decreased by about 22% from 2012 to 2016. The study attributes this, in part, to lower fuel costs, lower distribution charges, and lower systems loss, among others.¹² However, FGD participants noted that electricity rates in the Philippines are a limiting factor to SME growth. In relation to this, the PCC, in coordination with industry regulators, may conduct a market study to identify the sources of these constraints, and whether competition problems exist.

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¹² Mirafior, Madeleine B., (2016). "PH power rates no longer the 2nd highest in Asia," Manila Bulletin, October 1, 2016. Available at <http://2016.mb.com.ph/2016/10/01/ph-power-rates-no-longer-the-second-highest-in-asia/>. Accessed July 13, 2017.