

**CASE STUDY**



# **Opening up the Philippine Telecommunications Industry to Competition (II)**

**Prepared by  
Rafaelita A.M. Aldaba  
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## Conclusions and Policy Recommendations

The opening up of the telecommunications sector has provided significant benefits to the economy. The liberalization of the sector allowed the entry of new players resulting in rapid growth of the network, increase in foreign investment, access to technology and opportunities for companies to improve efficiency, and the emergence of new services. Our experience has shown that liberalization alone is not sufficient to foster effective competition. To achieve effective competition in the telecommunications sector, the interconnection between the incumbent and the new entrants must be guaranteed. If effective competition has to emerge, regulatory reforms have to be accompanied by clear rules on interconnection and terms of access that would lead to the creation of competitive market and industry structures. This could be achieved through carefully designed competition laws and regulation that could be efficiently implemented.

Our experience has shown that the combination of a weak regulatory authority, vague interconnection or access rules and pricing, and a large, dominant carrier capable of exercising monopoly power over access to its network has prevented true competition from taking place. As PLDT has the most extensive network, it was able to influence not only the speed and the terms and conditions for interconnection but the terms and conditions for revenue-sharing arrangements as well. This resulted in the slow progress of interconnection, difficulties of new entrants in getting interconnection and problems in drawing up satisfactory revenue sharing arrangements with PLDT.

Due to the slow pace of interconnection, consumers have been complaining over the large number of failed connections. Swamped with these complaints, PLDT and the other players have been fighting over responsibility for poor connections. The new carriers are accusing PLDT of deliberately dragging its foot on interconnection as a strategic means of restricting market share. On the other hand, PLDT maintains that the interconnection issue is primarily a technical and financial issue for it. Amidst these conflicts, NTC has taken a largely “hands-off” attitude.

Aside from the interconnection problem, another important issue is the reconcentration taking place in the industry. The government-backed PLDT-First Pacific merger is expected to bolster PLDT’s control of the industry. Note that First Pacific’s cellular phone company Smart is the leader in the cellular phone market. The PLDT-Smart merger can create an industry giant with combined telephone and cellular phone subscribers of 4,583,740 which account for about 66.3 percent of the country’s total subscribers. With the merger of the dominant firms in the fixed and mobile markets, the dangers of the return to monopoly abuse and reduction in competition have been raised.

Another lesson that could be drawn from our experience is that there still remains much work to be done with respect to establishing an effective regulatory institution and adequate regulatory laws towards the goal of ensuring competition in the telecommunications industry. Effective regulation is a complex activity that requires a learning process. Given our lack of regulatory tradition, limited administrative capabilities, lack of independence, and the information asymmetry problem in the industry, effective regulation remains a considerable challenge.

This brings us to a more fundamental question: Is it possible to achieve effective competition in an environment characterized by the presence of a large influential telecommunications firm, weak institution and fragile regulatory system which is prone to corruption and political pressure? In designing policy recommendations for the industry, we have to bear in mind that the regulatory environment in which telecommunications firms operate lacks institutional strength and credibility. Given this limitation, what should be done to achieve the goal of effective competition in the telecommunications industry?

It is important to note that the strong institutional foundations on which successful developed countries' competition and regulation system rests is absent and cannot be readily constructed in the Philippines. Despite its feeble institutional foundation, the country has continued to liberalize many sectors of the economy and enacted regulatory laws, though inadequate, to accompany its liberalization policy. While mistakes have been made along the way and are still expected to be made in the future, these should not discourage the country from adopting liberalization and competition policies. Given its complexities, the goal of operating an effective regulatory system, on which effective competition rests, is difficult although, through a gradual learning process this may not be impossible to achieve. The country has a strong network of professional associations from which competition policy experts could be tapped to perform complex regulatory assessments. This represents a strength that the country can take advantage of. There are also some sectors in civil society (NGOs, media, academia, and consumer groups) that advocate more competition and level playing field in various industries. These sectors can exert more pressure both on the government so that it becomes more transparent and accountable in its regulatory functions and on the firms so that they become more socially responsible and curb their anti-competitive practices.

With liberalization, NTC has been overwhelmed with regulatory issues and transactions that the introduction of competition entailed, consumer complaints, and interconnection disputes between the new carriers and the incumbent. All these tested its capacity to efficiently regulate. The NTC has obviously no or very little conceptual and practical experience on competition policy and effective regulation of the telecommunications industry. Therefore, it must be strengthened to become technically equipped to manage and effectively handle competition and regulation. To cope with its administrative weaknesses and improve its enforcement authority, NTC must invest in institution building activities such as training a small group of capable professionals with law or economics background. An extensive training on competition, regulatory practices and gathering necessary information is important in order to develop the human capital to do its job well. This core group could then train the commission's staff. There may also be a need to exempt the commission from civil service salary standards to make it more attractive to competent professionals and retain well-qualified staff. Finally, a reorganization and restructuring of the commission may be necessary in order to improve the NTC and ensure that it suits the new regulatory process that it must administer.

To build its credibility and establish its independence, there is a need to remove the appointment of the NTC commissioner from the political process. While this does not guarantee that the executive branch of the government will not interfere in its decisions,

this is one important step to lessen political interference and establish its autonomy. Furthermore, the funding of the NTC should be internally generated instead of the current budget allocations coming from the government. This way, NTC becomes detached from political interference. NTC officials should preferably come from the academia or from groups known to have no political agenda. They should not come from the group of telecommunications executives. In the same manner, telecommunications regulators should not be allowed by the government to be employed in the telecommunications industry. The current ban preventing government regulators from being employed in their subject industries should be strictly enforced. These changes are necessary in order to reduce the vulnerability of the system to influence and to avoid capture by special interest groups.

The regulatory framework and processes must be made as transparent as possible. This could be achieved by clearly specifying the rules, opening up the process, and explaining decisions. NTC should publish its decisions and deliberations, improve public access to its service, and strengthen the procedures for hearing complaints. The regulatory system must also be designed to overcome informational disadvantages which may require sophisticated administrative capabilities.

Revisions are needed in order to address the vagueness of some of the laws that NTC enforces and establish clear and efficient pricing, terms of access and interconnection. By now, it should be recognized that the SAS failed in providing interconnection between the incumbent and the new players. The geographical divisions that SAS imposed ignored the economies of scale characterizing the industry and led to the wasteful duplication of networks. SAS also maintained a large number of the advantages enjoyed by the incumbent. The high access charge limited the capability of new players to compete against PLDT.

As interconnection and terms of access to the network are key to opening the market, NTC should focus its regulation on the local exchange and on access to it. Furthermore, the power of the incumbent network operator to fight off the new players is significant and needs to be controlled to ensure access and protect consumers. Given a weak regulator which is incapable of restraining the incumbent, one alternative is to grant national franchises which will allow the consolidation of carriers that can pose a serious challenge to the incumbent. Franchises substitute competition for price regulation at the bidding stage. The advantage of franchises over regulation is that they impose no informational requirements on the government agency. Through a competitive franchise bidding process, efficient pricing is elicited and monopoly rents are dissipated (Guasch and Spiller). This is not something new: in the late 1990s, the operation of water and sewerage services in Metro Manila was concessioned through franchise bidding to the private sector. We could learn from the experience of the water sector and draw lessons which could be applied in the telecommunications industry.

The current wave of mergers taking place in the industry should be a source of concern. In particular, the PLDT-First Pacific deal has paved the way for the merger of two big carriers. Measures should be taken to prevent merging firms from acquiring substantial market power to deter entry and damage emerging competition.

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