



De La Salle University

**Competition in Philippine  
Telecommunications:  
A Survey of the Critical Issues**

**CBE Working Paper Series**

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**Competition in Philippine Telecommunications:  
A Survey of the Critical Issues**

**SERIES 2001-01**

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## **About the Author**

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# **Abstract**

*Dr. Ramonette Serafica*

Telecommunications liberalization in the Philippines has produced a number of benefits such as higher teledensity, greater variety of services, and to some extent lower prices. However, simply relaxing market entry restrictions has proven insufficient in creating a truly competitive environment. This paper looks at the state of competition in the Philippine telecommunications market and discusses the various threats to the competitive process in the industry. The paper also suggests areas for intervention from the standpoint of competition policy.

# Competition in Philippine Telecommunications: A Survey of the Critical Issues

Dr. Ramonette Serafica \*

*“It would be a truism to say that the most effective forms of competition we have, or can have, are imperfect forms, since there are no others. But it will mean something if we can find, after due examination, that some of these forms do their jobs well enough to be an adequate working reliance—more serviceable, on the whole, than those substitutes which involve abandoning reliance on competition. And it would be useful if we can learn something about the kinds and degrees of “imperfection” which are positively serviceable under particular situations.”<sup>1</sup>*

## Introduction

The demonopolization of Philippine telecommunications can be considered one of the best legacies of the Ramos administration. It is hard to imagine of any other policy move that could have elicited the same supply response from the industry, particularly from the dominant operator.

This study seeks to improve on the achievements of liberalization by carefully analyzing the critical issues affecting competition in Philippine telecommunications. In particular, the objectives of the study are:

- To provide a clear and workable definition of competition policy especially as it applies to the telecommunications industry.
- To evaluate the state of competition in the Philippine telecommunications industry.
- To identify threats to the competitive provision of telecommunications services.
- To suggest policy and regulatory measures to ensure a contestable telecommunications market.

To begin, some basic concepts and principles are presented to better understand competition policy and its role in telecommunications. Next we will carefully review the state of competition in Philippine telecommunications by looking at the industry structure and the relevant regulation affecting firm conduct particularly with respect to pricing. Then, the experiences of local communities after the introduction of liberalization will be discussed followed by an analysis of the critical issues undermining the competitive environment. Specific recommendations to create a more competitive and efficient telecommunications market are presented last.

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\* Funding for this study was provided under a research grant from the Philippine APEC Study Center Network. The author acknowledges the research assistance of Ms. Jovie Importante. All errors are the sole responsibility of the author. This paper was earlier circulated as PASCN Discussion Paper series 2000-15.

<sup>1</sup> Clark, J.M. “Toward a Concept of Workable Competition,” *American Economic Review*. Vol. XXX No. 2 (June, 1940); 242.

## THE ROLE OF COMPETITION POLICY IN PHILIPPINE TELECOMMUNICATIONS

The virtues of competition are well known. Several efficiencies are attained in markets where there are many buyers and sellers none of which has market power, consumers perceive no product differentiation, information is costless, and where barriers to entry and exit do not exist. **Productive efficiency** is achieved because firms are forced to produce goods and services at minimum cost. **Allocative efficiency** is attained because only the right amount and mix of goods and services are produced at prices that reflect the opportunity cost of all resources utilized. **X-inefficiency** is avoided because the discipline of a competitive market will punish managerial slack or excesses. Equally important, **consumer welfare** is also maximized under a perfectly competitive market structure.

In reality, most industries do not possess all of the standard characteristics of a perfectly competitive model from which such efficiencies are supposed to emanate. In the case of telecommunications, massive capital requirements imply high barriers to entry and exit especially since a significant portion of fixed cost incurred is sunk. Telecommunications is also characterized by a network of switches, transmission links, and terminal or distribution points that give rise to economies of scale and scope. However, this does not mean that telecommunications is necessarily a natural monopoly. Being multi-product in nature, different portions of the telecommunications network can be opened to varying degrees of competition, although still not to the extent described in a perfectly competitive model. Another important characteristic of telecommunications is that it enjoys network externalities (also referred to as consumption scale economies), which means that the benefits from telecommunications increase with the number of users that one is able to reach. These economic properties of telecommunications have at least two important implications for policy-making and regulation.

First, since the industry is not perfectly competitive then unfettered market activity cannot be expected to produce outcomes that are always efficient or that promote consumer welfare. Traditionally, countervailing market power in industries such as telecommunications was simply called regulation (or monopoly regulation). Given that technological and market conditions have now allowed feasible and desirable entry of competition in some sub-sectors of the industry a more general set of rules under “competition policy” (which subsumes monopoly regulation) must be put in place. A proactive set of rules promoting competition is necessary to assist entry and ensure that fair competition is maintained particularly since an incumbent can use its position to undermine competition. An incumbent not only enjoys certain advantages from being the first mover in the market but it also controls certain facilities that are needed by the entrant for the delivery of its service. Without rules that explicitly deal with the potential for abuse of the dominant position then efforts to approximate the desirable results of a perfectly competitive market by simply relaxing market entry will not be effective.

As described in the “Concept Paper on Competition Law and Policy” prepared by the Tariff Commission,<sup>2</sup> competition policy refers to “all laws government policies and regulations aimed at establishing competition and, having done so, maintaining the same. It includes measures aimed at promoting, advancing and ensuring competitive market conditions by the removal of control, as well as redressing anti-competitive results, of public and private restrictive

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<sup>2</sup> Planning and Project Coordination Division (April 7, 1999).

practices.” According to Patalinghug,<sup>3</sup> the elements of an effective competition policy include: (a) policy towards a monopoly, (b) policy towards mergers, (c) policy towards restrictive and anti-competitive practice, (d) policy towards state entry barriers, and (e) policy towards consumer protection. This list is similar to those of Australia’s Hilmer Report,<sup>4</sup> which identifies the six elements of a competition policy as: anti-competitive conduct of firms, unjustified regulatory restrictions on competition, inappropriate structure of public monopolies, denial of access to certain facilities that are essential for effective competition, monopoly pricing, and competitive neutrality when government businesses compete with private firms.

In other countries particularly the U.S., antitrust laws govern the ways in which firms are allowed to compete with each other. Agreements among competitors (e.g., price fixing arrangements) and actions by a single firm that hurt rivals (e.g., denial of access to bottleneck facilities) are the main areas covered by antitrust policy. When no additional inquiry is required to determine whether or not a certain firm behavior violates antitrust laws then such conduct is said to be **per se illegal**. An example of this would be an agreement whose sole purpose is to fix price or restrict output. However, not all cooperative agreements are considered illegal especially when such arrangements are necessary to achieve pro-competitive purposes (e.g., the reduction in transactions costs). In such cases, the courts apply a **rule of reason** analysis whereby the reasonableness of the agreement is determined. To be sure, antitrust is not anti-monopoly. The intent of the antitrust laws is primarily to prevent business practices that would harm society through the exercise of market power.<sup>5</sup>

The second equally important point that needs to be recognized is that even as competition policy attempts to mimic the competitive market, tradeoffs among the desirable efficiencies will have to be made. For example, since fixed costs are involved then a policy of promoting entry will lead to lower x-inefficiency within the incumbent firm but will also result in a duplication of facilities in the industry. A merger, which exploits synergies and generates efficiencies, may have to be challenged if this creates a significant increase in market power (or the ability to set the terms of the market with respect to price or supply). If one of the government’s objectives is to encourage dynamic efficiency (i.e., innovation) then firms should be allowed to earn above normal profits or engage in tie-in arrangements to recoup investments in R&D. Note too, that the competitive model is silent on the issue of equity. Thus, prices may have to be distorted resulting in allocative inefficiency in the short term if this will translate to more people being able to access the telecommunications network thereby increasing the benefits for everyone in the long run.

Competition policy just like regulation will have to balance the conflicting interests of the various stakeholders—at times, even requiring intertemporal comparisons of welfare effects. Thus, the critical decision will have to be made in terms of choosing which among the different interests and objectives are more equal than others.

Given these considerations, what specific elements of competition policy are most relevant to Philippine telecommunications? The next few sections will discuss the state of the

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<sup>3</sup> Patalinghug, E.E. 1997. “Competition Policy, Technology Policy and Philippine Industrial Competitiveness,” *A Professorial Chair Paper* (College of Business Administration, University of the Philippines, Diliman, Q.C.), December 1997; 4-6.

<sup>4</sup> Cited in A Policy Framework for Competition Policy in the Philippines The Institute for Research in International Competitiveness (Australia) March 1999.

<sup>5</sup> See Carlton, D. W. and J.M. Perloff 1994. “Antitrust Laws and Policy” Chapter 20 of Modern Industrial Organization 2<sup>nd</sup> ed. (NY: Harper Collins College Publishers).

industry and its regulatory environment to aid us in identifying the rules that must be put in place to create a healthy competitive market.

## **THE MARKET ENVIRONMENT OF PHILIPPINE TELECOMMUNICATIONS**

As declared in the Public Telecommunications Policy Act of the Philippines (RA 7925), “A healthy and competitive environment shall be fostered, one in which telecommunications carriers are free to make business decisions and to interact with one another in providing telecommunications services, with the end view of encouraging their financial viability while maintaining affordable rates” [Article II. Sec 4f]. Telecommunications is defined as “any process which enables a telecommunications entity to relay and receive voice, data, electronic messages, written or printed matter, fixed or moving pictures, words, music or visible or audible signals or any control signals or any design and for any purpose by wire, radio or other electromagnetic, spectral, optical or technological means.” Accordingly, the Act specifies the following categories of telecommunications services: local exchange service, inter-exchange carrier service, international carrier service, value-added service, mobile radio service, and radio paging service.

The National Telecommunications Commission (NTC) is the agency that exercises jurisdiction over the supervision, adjudication and control over all telecommunications services. Although it is an independent regulatory body, the NTC remains under the administrative supervision of the Department of Transportation and Communication (DOTC) as an attached agency. However, in terms of its quasi-judicial functions, the decisions of the NTC can be appealed only to the Supreme Court. According to RA 7925, it is the responsibility of the NTC to “Foster fair and efficient market conduct, through, but not limited to, the protection of telecommunications entities from unfair trade practices of other carriers.” [Art. III Sec. 5d]

### **THE STRUCTURE OF THE INDUSTRY**

Table 1 shows the growth of the industry following liberalization. Although Philippine telecommunications has always been multi-operator in character, it was only until the issuance of the Executive Order 109 (and subsequently with the enactment of RA 7925) that the industry was effectively demonopolized. That there are no longer monopolies in the industry does not mean that no single operator today is able to exercise considerable market power but rather, that there are now at least two operators allowed to compete in the same geographic market for each of the service categories identified in RA 7925.<sup>6</sup>

Of these service categories, only value-added service has been deregulated such that even registration with the NTC is not being strictly enforced. Entry into the regulated segments of the industry occurs in two stages. The first step requires a congressional franchise to operate a telecommunications service in all or some parts of the country. The second phase involves applying for a Certificate of Public Convenience and Necessity (CPCN) or a Provisional Authority (PA) granted by the NTC, which requires carriers to demonstrate that they are technically and financially able to carry out the service and that sufficient demand exists. A description of the service, the specific rate or a general rate structure that may be charged for the service and the regulations under which that service can be provided are all contained in the PA.

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<sup>6</sup> Thus, this is the simple “single seller” definition of a monopoly. Whether or not certain firms control essential facilities and are thus able to behave like a monopolist will be discussed in a later section.

Table 1. NUMBER OF AUTHORIZED CARRIERS

<u>TELECOM SERVICE</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>
Local Exchange Carrier (LEC)	45	49	60	67	74	76	76
Cellular Mobile Telephone Service (CMTS)	2	5	5	5	5	5	5
Paging Service	6	6	10	11	14	15	15
Public Trunk Repeater Service	7	8	8	10	10	10	10
International Gateway Facility	3	5	9	9	9	11	11
Satellite Service	3	3	3	3	3	3	3
International Record Carrier	4	4	5	5	5	5	5
Domestic Record Carrier	6	6	6	6	6	6	6
Very Small Aperture Terminal	4	4	3	3	3	4	4
Public Coastal Station	13	13	13	12	12	12	12
Radiotelephone	4	6	6	5	5	5	5
Value-Added Service	-	-	-	1	27	47	70

Source: National Telecommunications Commission Annual Report (1997, 1998)

EO 109 forced the creation of several vertically integrated multi-service firms. In addition to the Philippine Long Distance Telephone Company, Inc. (PLDT), there are now nine other firms engaged in various telecommunications services. Moreover, most of these firms have positioned themselves further downstream in value-added service, either through an affiliate, subsidiary or sister company. (See Table 2)

TABLE 2. SCOPE OF SERVICES

<i>SERVICE</i>	<i>BAYANTEL</i>	<i>CAPWIRE</i>	<i>DIGITE L</i>	<i>ETP I</i>	<i>GLOBE</i>	<i>ISLACOM</i>	<i>PHILCO M</i>	<i>PILTE L</i>	<i>PLDT</i>	<i>SMART</i>
<i>IGF</i>	X	X	X	X	X	X	X		X	X
<i>LEC</i>	X	X	X	X	X	X	X	X	X	X
<i>CMTS</i>					X	X		X		X
<i>VAS</i>	X	X	X		X				X	X

Although all carriers were given a national franchise, PLDT is the only carrier that operates local exchange service (including Public Calling Offices) all over the country while the rest are restricted by their PAs to serve only specific geographic areas (See Table 3). In addition to these vertically integrated firms, there are about sixty-six (66) other licensed provincial operators who have been providing LEC service on a limited scale. Four of these pure LEC operators are government-owned and should be privatized soon as mandated by RA 7925. At the aggregate level, PLDT accounts for about sixty percent (60%) of the total subscribed lines (See Graph 1) and remains the dominant operator in the most lucrative service area, Metro Manila. In Luzon, DIGITEL is emerging as the dominant operator while for the rest of the country no single firm consistently enjoys the dominant position for competition in the so-called “last mile connection”. Appendix A identifies the dominant and fringe operators in each of the provinces.

TABLE 3. SERVICE AREAS

REGION	BAYANTEL	CAPWIRE	DIGITEL	ETPI	GLOBE	ISLACOM	PHILCOM	PILTEL	PLDT	SMART
NCR A				X					X	
NCR B	X								X	
NCR C					X				X	
NCR D									X	X
CAR A			X					/	X	X
CAR B			X	X					X	
I			X						X	X
II			X	X					X	
III			X					/	X	X
IV A		X	X					/	X	
IV B			X		X			/	X	
V	X		X					/	X	
VI						X			X	
VII						X			X	
VIII						X			X	
IX							X	X	X	
X							X	X	X	
XI							X	X	X	
XII					X				X	
CARAGA							X	X	X	
ARMM A					X				X	
ARMM B							X	X	X	

Notes:

1. Coverage:

National Capital Region (NCR)

A – Manila, Navotas, Caloocan City

B – Quezon City, Valenzuela, Malabon

C – Makati, San Juan, Mandaluyong, Marikina, Pasig

D – Pasay City, Las Pinas, Paranaque, Pateros, Taguig, Muntinlupa

Cordillera Administrative Region (CAR)

A – Abra, Benguet, Mountain Province

B – Apayao, Ifugao, Kalinga

Region I (Ilocos Region) – Ilocos Norte, Ilocos Sur, La Union, Pangasinan

Region II (Cagayan Valley) – Batanes, Cagayan, Isabela, Quirino, Nueva Vizcaya

Region III (Central Luzon) – Bataan, Bulacan, Nueva Ecija, Pampanga, Tarlac, Zambales

Region IV (Southern Tagalog)

A – Aurora, Laguna, Marinduque, Quezon, Rizal, Romblon

B – Batangas, Cavite, Occidental Mindoro, Oriental Mindoro, Palawan

Region V (Bicol Region) – Albay, Camarines Norte, Camarines Sur, Catanduanes, Masbate, Sorsogon

Region VI (Western Visayas) – Aklan, Antique, Capiz, Guimaras, Iloilo, Negros Occidental

Region VII (Central Visayas) – Bohol, Cebu, Negros Oriental

Region VIII (Eastern Visayas) – Biliran, Eastern Samar, Leyte, Northern Samar, Southern Leyte, Western Samar

Region IX (Western Mindanao) – Basilan, Zamboanga del Norte, Zamboanga del Sur

Region X (Northern Mindanao) – Bukidnon, Camiguin, Misamis Occidental, Misamis Oriental

Region XI (Southern Mindanao) – Davao, Davao Oriental, Davao del Sur, South Cotabato, Sarangani, Compostela Valley

Region XII (Central Mindanao) – Lanao del Norte, North Cotabato, Sultan Kudarat, Cotabato City, Marawi City

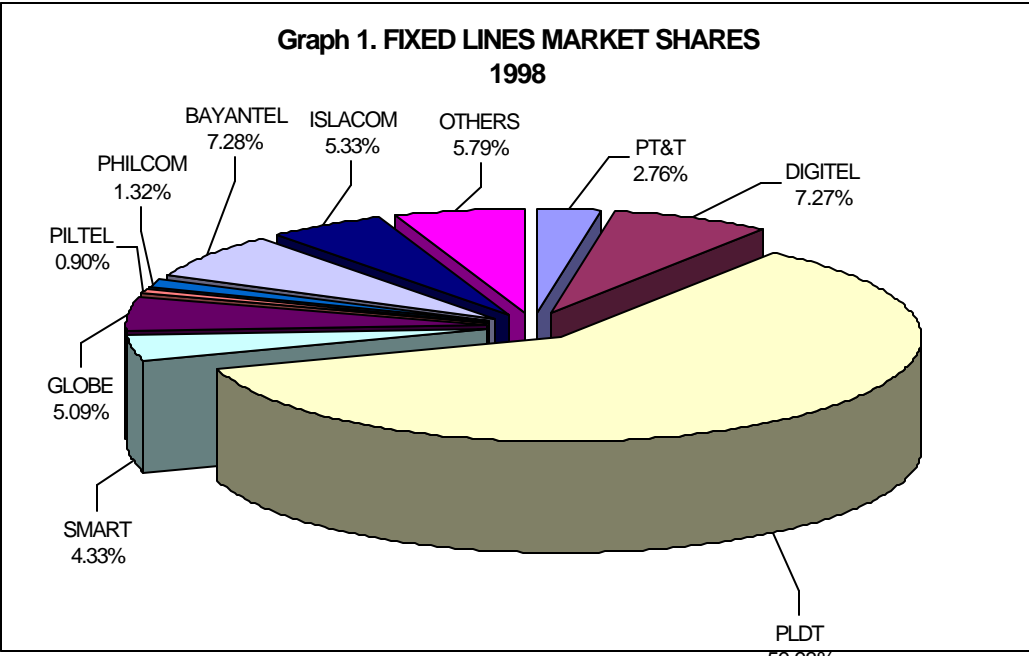
Region XIII (CARAGA) – Agusan del Norte, Agusan del Sur, Surigao del Sur, Surigao del Norte

Autonomous Region in Muslim Mindanao (ARMM)

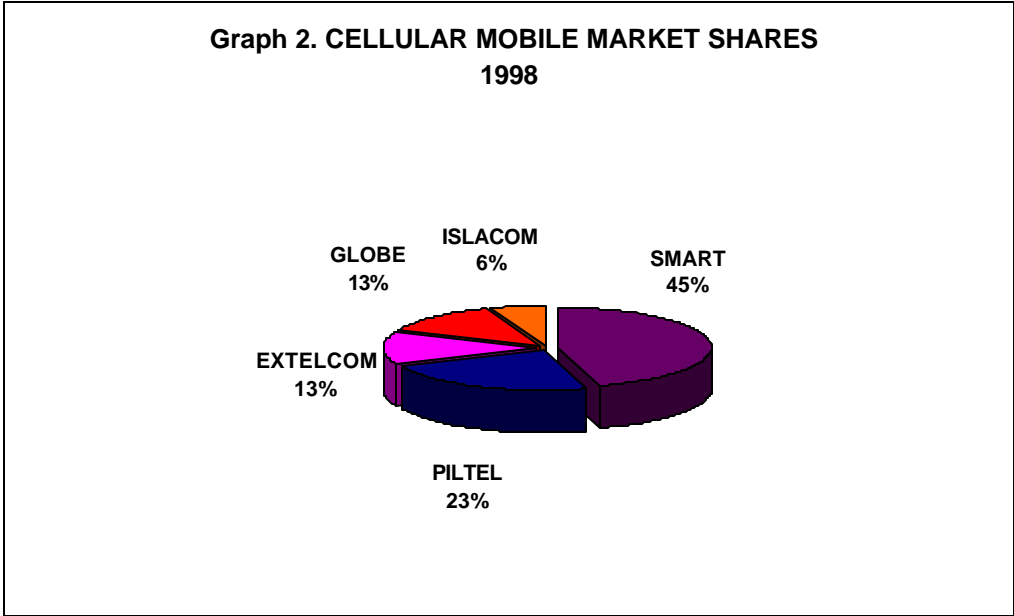
A – Lanao del Sur, Maguindanao

B – Sulu, Tawi-Tawi

2. / - Select areas only: Baguio (CAR); Olongapo and Subic (Region III); Puerto Princesa and Boac (Region IV); Masbate (Region V)



PLDT remains the dominant firm in the fixed line business and its market share at the national level still larger than all competition combined. For 1998, the leader in the mobile market was SMART. (See Graph 2)



## THE ECONOMIC REGULATION OF THE INDUSTRY

### DETERMINATION OF END-USER PRICE

Traditionally, the industry adhered to a return on rate base (ROB) regulation, which set the maximum allowable return of 12% based on the net book value of property, plant and equipment plus working capital covering two months average operating expenses. Another principle, which guided rate setting, was the policy objective to maintain the affordability of basic telephone service especially for residential use. With these two constraints, price regulation for a multi-service, vertically-integrated firm such as PLDT resulted in cross-subsidization whereby the rates of some services were set above cost (i.e., international long distance) in order to cross-subsidize LEC service which was presumably priced below cost.

The collection rate, or the price charged to consumers for international long distance calls are partly influenced by the international accounting rate system whereby carriers, for example, PLDT and American Telephone & Telegraph (AT&T), would agree on the price (the accounting rate) of a call between the Philippines and the US such that the originating telco would remit half of the accounting rate (the settlement rate) to the terminating telco. The collection rate was set higher than the accounting rate so that local service could be made affordable and still enable PLDT to earn the allowable rate of return. In recent years however, the collection rates have been allowed to decrease by the NTC as a result of international pressures, spearheaded by the US Federal Communications Commission (FCC), to reform the accounting rate system in favor of lower rates that reflect actual costs and to maintain a balance between outgoing and incoming international toll traffic. The need to cross subsidize local telephone service (i.e., prevent increases in basic rates) and encourage network expansion has prevented the NTC from deregulating the prices of international calls altogether.

For the case of local service, the price that subscribers pay consists primarily of two parts: the base rate and the foreign currency adjustment (FCA). The base rate is generally set low and does not change frequently. The monthly rates charged to consumers however move with changes in the Peso-Dollar exchange rate. For example, prior to PLDT's implementation of rate rebalancing in December of 1997, the base rates for Metro Manila were fixed at PhP 110 for residential subscribers and PhP 232 for business subscribers, which were set way back in 1983. Since then the final prices charged to subscribers have increased as a result of the foreign currency adjustment, which allows utilities such as PLDT to automatically adjust the rates by 1% for every PhP 0.10 increase/decrease in the Peso-Dollar exchange rate. The adjustment factor, which is based on a moving reference exchange rate, is then multiplied by the base rate to determine the FCA. The FCA is added/subtracted to the previous rate to arrive at the new monthly rate.<sup>7</sup> Thus, by October 31, 1997, the prevailing rates were PhP 326.41 and PhP 728.30 for residential and business subscribers, respectively. An additional 10% tax is added to the final price.

Base rate increases are not automatic and still have to be reviewed by the Commission. RA 7925 eliminated the 12% ceiling<sup>8</sup> but provided no basis for the determination of "fair and

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<sup>7</sup> Other carriers compute the FCA using a fixed reference exchange rate as specified in their PA. As such, the FCA is added to the original base rate and not to the previous rate to arrive at the new monthly rate.

<sup>8</sup> See NTC 1997 Annual Report, 10.

reasonable” rates. The industry has been pushing for rate rebalancing<sup>9</sup> and metering. In the absence of a set of principles and concrete guidelines for rate setting, the resolution of these issues remains contentious.

#### DETERMINATION OF ACCESS PRICE

Although end-user rates are regulated and set by the NTC, the price of intermediate goods (i.e., access charge) is negotiated between interconnecting carriers. As specified in the RA 7925, the access charge is supposed to “make provision for the cross subsidy to unprofitable local exchange service areas.” [Article III Sec. 5 c]. More generally, the rates of interconnection must take the following into consideration [Article III Sec. 18]:

- 1) The costs of the facilities needed to complete the interconnection,
- 2) The need to provide the cross subsidy to local exchange carriers to enable them to fulfill the primary national objective of increasing telephone density in the country, and
- 3) Assure a rate of return on the total local exchange network investment that is at parity with those earned by other segments of the telecommunications industry.

The actual level and the structure of the access charge differ depending on the type of interconnecting service. PLDT adopts the following commercial arrangements, which is the de facto industry practice:

“IGF interconnection involves payment of access charges, whereas toll calls for IXCs and LECs are settled based on revenue sharing. CMTS interconnection settlement for local calls is also based on access charges; for toll calls, the basis is revenue sharing. LEC to LEC interconnection with hauling from one service area to another service area is settled based on trunk charges, while overlay LEC to LEC interconnection in a given service area has no charges. Paging and trunk radio interconnection settlements are based on fixed charges.”

(Source: PLDT 1998 Annual Report p.33)

Obviously, a firm can deliberately effect a price squeeze on a competitor under a setup where the price of an intermediate good is negotiated while that of the final good is set by the regulator. What is not obvious is that regulatory lag can cause the same as what GLOBE experienced (*See Box*)

#### **THE NATURE OF COMPETITION AT THE LOCAL LEVEL: 3 CASES**

##### How regulatory lag can be anti-competitive

As mentioned, access charges on national long distance calls are typically in the form of revenue sharing, which in turn is based on the approved collection rate. In the past, GLOBE had suffered a price squeeze when PLDT increased its access charge as a result of its approved rate rebalancing while GLOBE could not pass on the higher access charge to its subscribers since its petition for rate rebalancing had not been approved.

The liberalization of the telecommunications sector has been beneficial to the country. The single most important achievement of liberalization is that it has expanded consumer choice.

<sup>9</sup> To date, only the applications of PLDT, BAYANTEL, and GLOBE for increases in basic rates (as part of rate rebalancing) have been approved although almost all carriers filed in 1997 to early 1998.

Although it was technology that enabled more access options to become available (e.g., cellular and landline), it was the deliberate policy of expanding supply via the entry of new players that has produced the gains for consumers. Carriers strive to be the first to provide advanced features that current technology makes possible (e.g., caller id, three-way calling). Moreover, in today's market, carriers actively seek out customers- a scenario that was unimaginable before.

In this section, we present the experiences of three communities with regard to the introduction of competition at the local exchange level. These cities were selected because of the unique competitive environment that can be found in each market.

#### DAGUPAN CITY

*Population: 128,499 (1998)*

*Land Area: 43.6 sq. km*

*Population Density: 2,945/sq. km*

*Classification: Component City*

*Income Class: 1<sup>st</sup>*

**T**elecommunications services available in Dagupan City consist of telegraph, telex, fax, cellular phone, fixed line, paging and other auxiliary facilities such as public payphones and public calling stations. For their basic telephone needs, the city has three full service telecommunications firms to choose from, namely: PLDT, DIGITEL, and SMART.

It is not uncommon for establishments or even some households to subscribe to more than one carrier. But although the first suspect for this kind of behavior is interconnection, which both carriers and subscribers say has been resolved, the main explanation for patronizing more than one carrier appears to be product differentiation.

Subscribers like PLDT because of its flat rate and the fact that it is still easier to call Metro Manila using a PLDT line. Being first in the area also helps in that long time customers would rather acquire a second line than give up his or her PLDT connection or phone number.

DIGITEL's appeal is the wider calling area for local calls (i.e., no long distance charges for DIGITEL-TO-DIGITEL calls within the province). The fact that it is metered does not seem to deter subscribers as DIGITEL has designed three calling plans which they can choose from, namely: Choice 150, 300, and 750. Each plan provides an allowance for both local and long distance calls. Interestingly, when the company introduced the usage-based monthly plans for telephone service in June of 1997, it took efforts to assist subscribers in selecting the calling plan that best suits their needs by coming up with some guidelines based on their calling habits and budget. For example, Plan 150 was being marketed as appropriate for the following subscriber type: use of telephone is limited, average monthly charges on long distance calls is less than P100 or the average monthly bill is less than P376, and customer wants to limit phone expenses to P150 only. For the other types of subscribers, DIGITEL designed alternative calling plans so that subscribers can self-select. (*See following Box*)

To introduce (and sell) the idea of metered service to its subscribers, DIGITEL inserted a letter in the monthly billing statement entitled "The Freedom of Choice", which reads:

The Freedom of Choice

Dear Digitel Subscriber,

Starting June 25, 1997, we bring you CHOICE.

CHOICE allows you to choose your own monthly telephone charging plan. CHOICE also reduces calling rates by as much as 90%. This new usage-based monthly plan for telephone service was recently approved by the National Telecommunications Commission. It provides great value to frequent users by giving more talk-time at less expense. This unique charging scheme is exclusive to Digitel subscribers.

CHOICE has three plans especially designed to suit your varying calling needs and budget. No longer will you be classified as a residential or a business subscriber. With Choice, pay a **fixed-monthly rate of either P150, P300 and P750** and you get corresponding built-in call allowances. As your need changes, you can shift from one CHOICE plan to another, as often as you like, for a minimal fee.

CHOICE is your "customized" telephone pricing plan only from Digitel.

SMART is the latest carrier to enter the local exchange market in Dagupan City. It still has to establish its distinguishing brand of service so it is not yet considered as the first choice. Some subscribers avail of SMART only when they are unable to get a line or are still waiting for one from their preferred carrier.

**C**ommunication now is relatively easy in Naga City with the availability of 3 telegraph offices, 8 courier services, 2 local telephone operators, long distance telephone operators, 2 cellular phone operators, 1 pager operator, 4 cable television stations, 6 television stations, 20 radio stations, and 12 local weeklies. The government's National Telephone Program Bicol switching station, a major mode of the Luzon - Mindanao communication backbone, is located in Naga City.

NAGA CITY

*Population: 126,972 (1998)*

*Land Area: 77 sq. km*

*Population Density: 1,649/sq. km*

*Classification: Independent*

*Component City*

*Income Class: 1<sup>st</sup>*

Since 1997, there have been two landline operators in Naga City - BAYANTEL and DIGITEL. Prior to the duopoly situation, only one company, Naga Telephone Company (NATELCO), provided local service in the area for more than twenty years.

NATELCO was eventually bought by BAYANTEL, which is now operating under the franchise granted to NATELCO in 1978 under Resolution Number 5 of the city council granting a 35-year franchise to NATELCO. Initially, BAYANTEL operated in the Province of Albay, Camarines Norte, Camarines Sur and Sorsogon in the Bicol Region. It has an estimated subscriber base of 14,000 in Naga.

DIGITEL's entry into Naga City is not through a buy-out of a local company. Instead, it bought the operating rights from DOTC, which had an existing telephone project in Naga. At present, DIGITEL has an estimated 5,000 subscribers. As mentioned previously, DIGITEL adopts metered service although it offers several calling plans so subscribers can choose depending on their own needs. An applicant pays an installation fee, depending on the plan chosen. The installation fee includes installation charges, service activation fee, advance monthly fee, 10% VAT, instrument deposit, and city electrician inspection fee. The installation fees for residential and business applicants are of the same amount.

Unlike DIGITEL, BAYANTEL does not apply metering. It collects a monthly charge of P472.88 from its residential subscribers. This rate includes the local charge, FCA, and 10% VAT. For business subscribers, the monthly charge is P979.75 covering the same charges as the residential.

Each carrier has its own set of advantages that subscribers take into account. In fact, there are those, businesses especially, that subscribe to both. A cursory survey of these establishments reveal that the advantages of having a DIGITEL phone is that it has clearer transmissions and connects easily especially when making long distance calls. However, they use their BAYANTEL phones when making lengthy calls.

Both operators offer similar telephone features, which include caller ID, security pin, and call waiting. The two also offers "Instant Connection" or "Same Day Installation".

BAYANTEL offers "Oplan Kabit Agad" granting 50% discount on the installation fee. Aside from the special telephone features and the instant connection offered by BAYANTEL, they also conduct house calls and send letters to potential subscribers. For the convenience of customers, BAYANTEL employs agents who collect payments directly from the subscribers instead of having them travel to the BAYANTEL office.

DIGITEL's version is called "Katok-Kabit", connecting the telephone the same day that the installation fee is paid. In general, DIGITEL has a lower installation fee than BAYANTEL. Recently, it also lowered its long distance rate to 3.00 per minute known as the "Pakikisama" rate. In addition to providing telephone service, DIGITEL now offers Internet service to its subscribers.

Within Naga City, there is no interconnection problem between the two telephone companies. Subscribers of both companies can call each other without having to worry of incurring long distance charges.

CAGAYAN DE ORO CITY

*Population: 487,282 (1998)*

*Land Area: 488 sq. km*

*Population Density: 998/sq. km*

*Classification: Highly Urbanized City*

*Income Class: 1<sup>st</sup>*

Of the eighty-two (82) cities in the Philippines, Cagayan de Oro has the most number of telephone operators. Currently, there are four (4) landline carriers operating in the city. These are Misamis Oriental Provincial Telephone System (MISORTEL), Cruz Telephone Company (CRUZTELCO), National Telephone Program Tranch 1-3, and PHILCOM. It is quite common in Cagayan de Oro, especially in commercial areas, to subscribe to two telephone companies. Unfortunately, the reason is quite different from that in Dagupan City.

MISORTEL is the oldest operating telephone company in Cagayan de Oro, operating for a few decades now. It is owned by the Misamis Oriental Provincial Government. As the first and the oldest, MISORTEL claims to enjoy the biggest market share in the city estimated at around seventy percent (70%) while the remaining thirty percent (30%) subscribers are shared by the other three telephone carriers.

An applicant is charged P6,600.00 by MISORTEL. The amount is broken down as: P5,000.00 for refundable deposit; P1,500.00 for the telephone unit and; P100.00 for installation. Commercial subscribers are charged P450.00 monthly plus EVAT. Residential subscribers pay a monthly rate of P220.00, which includes the EVAT. Supposedly, installation takes one to two weeks.

Becoming aware of the stiff competition they are facing, the management started introducing marketing innovations. A customer care department was set up in the early part of 1999. Research was done on target clients especially on corporations and commercial establishments. Calls and visits to potential clients were made. Special attention was given to customer complaints. MISORTEL became active in sponsoring shows and special events. Phone booths offering "free calls" were put up in the MISORTEL office, city hall, and other strategic public places.

The management wants to change the public perception that because MISORTEL is a government-owned company, it will be run as the "usual" government office. A slogan and logo contest was launched, changing the MISORTEL logo from the provincial government seal into a more corporate looking one.

Among the four telephone carriers, CRUZTELCO is the newest addition having started operations in the city only in March 1998. It took four years before it got its permit to operate from the city government. Its service covers the Province of Misamis Oriental and within the city limits of Cagayan De Oro.

The installation rates of CRUZTELCO is relatively cheaper amounting to P2,558.00. This amount covers P300.00 installation fee, P558.00 installation materials, and P1,700.00 for the telephone set. Monthly rate for residential line is P242.00 including EVAT. Commercial subscribers are charged P423.50, which also includes EVAT.

CRUZTELCO's subscribers are typically those not served by other landline carriers. Usually, CRUZTELCO does a survey and their services are offered to those who do not have existing telephone lines. Mostly, service provision is concentrated in areas outside the city proper. Based on customers' feedback, they avail of CRUZTELCO's services because of the cheaper cash outlay when applying for installation.

The National Telephone Program Tranch 1-3 is a DOTC Project offering landline telephone service to areas in Cagayan de Oro, which are outside the city proper. Focus is in providing telephone service to *barangays* in the city peripheries. The contractor for the Project is ITALTEL. Monthly rate for residential subscribers is P249.85 and P419.40 for commercial subscribers. It has been its policy not to poach the other carriers' subscribers and instead concentrate on the unserved.

PHILCOM's entry into the city is by virtue of the previous administration's basic telephone program. As an international gateway facilities operator, it was required to install 300,000 landlines in its service area, which is the Mindanao region. Because of this requirement, although MISORTEL has the highest number of subscribers, PHILCOM is said to have the most number of available lines.

Direct interconnection is only possible between MISORTEL and NTP. For the rest, in order to make calls between two different carriers, a long distance rate is charged. This poses a financial burden to subscribers especially to those who are frequent business callers.

Burdened by the interconnection problem and seeing no immediate action from the service providers, subscribers have employed strategies to make the situation bearable. Most subscribers, especially those engaged in business have at least two service carriers. Choice of carrier is based on the number of subscribers of the carrier and one's calling circle, typically MISORTEL and PHILCOM. In this manner, they can make as many calls as needed without incurring long distance charges. Another strategy is to acquire a cellular phone. This allows subscribers to call any subscriber of the different LEC service operators.

In an effort to alleviate the situation, City Council Resolution No. 4027-98 requests the Office of the President to include Local Government Units as a negotiating party in solving the interconnection problem of service providers. The council feels that with the LGU being authorized and directly involved in the situation, they can make telephone companies sign an interconnection agreement.

## POST-LIBERALIZATION: ISSUES AND CONCERNS

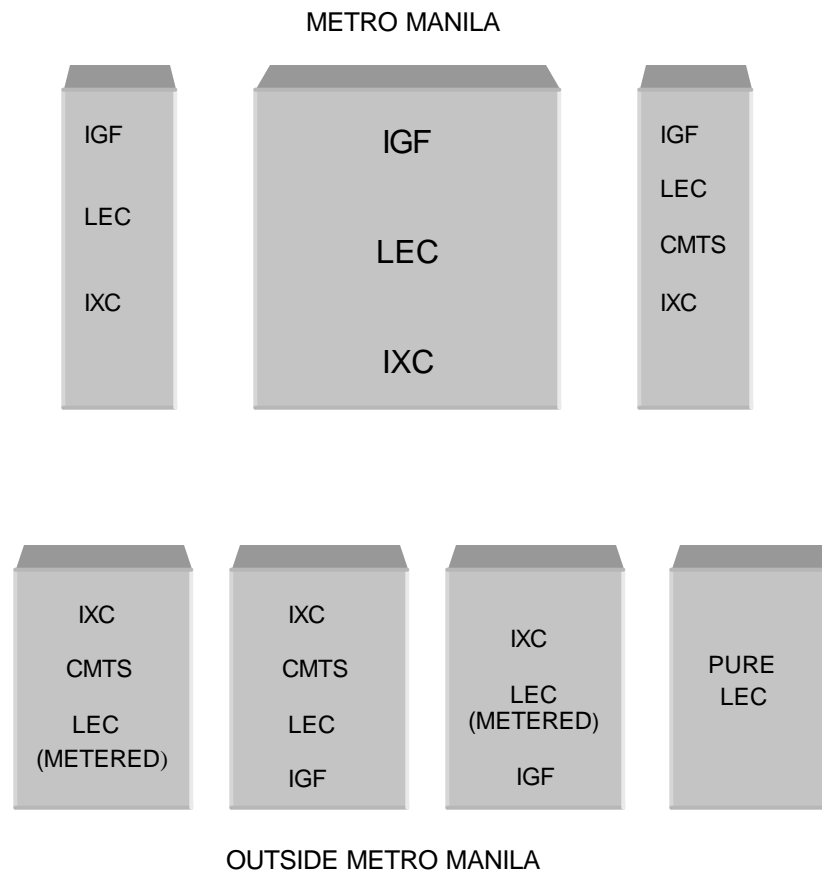
Although liberalization has addressed many consumer woes from poor quality of service to absolute lack of service, some problems have been created as well, thereby diminishing the potential gains that could be derived from a competitive environment. In addition, certain developments in both the technology and regulatory fronts pose new challenges to the competitive model.

### INTERCONNECTION

The most critical issue that has emerged from the liberalization of telecommunications is interconnection, which is required to enable subscribers of different carriers to communicate with one another or enjoy the services of other carriers.

Diagram 1 depicts the different types of multi-service telecommunications firms operating in the Philippines. In Metro Manila, there are at least five carriers with PLDT controlling the bulk of the subscribed lines. The other operators provide the same services as PLDT or are licensed CMTS carriers as well. In the provinces, the type of carriers can range from simple LECs to full service operators.

Diagram 1. Interconnecting Carriers & Services



In general, interconnecting  $n$  carriers would require  $[n(n-1)]/2$  agreements. However, interconnect agreements are not made for interconnecting carriers per se but for each of its service (e.g., CMTS, LEC, IGF, etc.) thereby increasing the theoretically maximum number of interconnection contracts that must be specified, negotiated, and enforced. Both the technical and the commercial aspects of interconnection contracts are negotiated on a bilateral basis and the role of the regulator is merely to mediate, in practice through moral suasion, whenever parties fail to reach an agreement.

As mentioned in the previous section, the price of interconnection, which can take the form of an access charge or a share of the revenues, is not regulated. RA 7925 and its Implementing Rules and Regulations provide some guidelines (See Appendix B) but these have proven to be inadequate in resolving interconnection issues. Being bilateral in nature, settlement of the terms of interconnection is determined by the relative bargaining strengths of the carriers. Access payments usually make up a significant portion of the operating costs of a new entrant (e.g., 30-40%) while it is a source of revenues for incumbents particularly in the beginning when the direction of calls is from subscribers of the new carriers to the subscribers of incumbents. Thus, the access charge is very important to business survival.

New operators, have complained in the past of unfair conduct by the dominant firm, PLDT. These include, among others, insufficient interconnection, unequal access settlements or revenue sharing arrangements as well as the use of interconnection as a lever in other commercial negotiations. To be sure, alleged unfair or uncooperative behavior is not limited to PLDT as other incumbent operators (e.g., Cagayan de Oro case) have also been reluctant to interconnect or grant favorable terms of interconnection to competition.

From the subscribers' end, the interconnection problem is felt in terms of unsuccessful call attempts and irrational calling charges. Although no official figures are publicly reported, call failure rates as a result of poor interconnection are believed to be well above the 2.5% to 1% prescribed under the NTC regulations. Subscribers have also complained of unreasonable long distance charges for calls to nearby telephones, even to neighbors. (*See Box*)

In the office of Meycauayan Mayor Eduardo Alarilla there are two telephones that are separated by a divider. One is a Digitel phone while the other is from Racitelcom. In order to talk to someone on the other side of the divider one has to dial the Bulacan area code and incur a PhP 4 per minute charge because it is considered a long distance call.

*Source:* Mauricio, Orlan L. "Probe of Phone Firms Ordered," *Manila Standard*, September 23, 1999 issue, A3.)

## MERGERS AND VERTICAL INTEGRATION

Industry consolidation has been expected ever since the onset of liberalization. The number of firms that entered the market was seen as more than sufficient for the Philippine market and only two to three multi-service telecommunications firms were expected to survive. New operators would eventually merge with each other to gain significant market share vis-à-vis PLDT, which would remain as the leading firm within the short to medium term.

In November 24, 1998, the long-anticipated industry consolidation was officially set in motion with the acquisition by First Pacific of 17.2 economic interest in PLDT paving the way for the eventual merger of PLDT, PILTEL, and SMART. The integration of their respective fixed, mobile, and internet/multimedia lines of business is expected to generate efficiencies in terms of infrastructure use, network operations, network development and planning, customer care, billing, and other support services.

Despite the obvious benefits, not everyone greeted this development with enthusiasm. The trepidation was understandable because the merger that was taking place was not between fringe operators but between the dominant firms in the fixed and mobile markets. Immediately, fears of the return of monopoly abuse were raised.

A reading of the events that transpired in the second part of 1999 indicates that there is a real danger of abuse of market dominance with the merger. Although SMART is the industry leader in the mobile market, GLOBE is the recognized leader in digital technology which is largely propelled by the popularity of its short messaging service. By the time that SMART had launched its digital cellular service that could offer the same feature, subscribers were already hooked on GLOBE's text messaging, which was possible only among GLOBE subscribers. This made it difficult for SMART to entice subscribers to switch. Around the same time that SMART was negotiating for interconnection with GLOBE's text messaging, which it obviously found difficult to obtain, PLDT accused GLOBE of misrepresenting calls to avoid paying correct access charges and subsequently restricted GLOBE's interconnection with PLDT's landlines. The motive behind the action taken against GLOBE would not have been suspect were it not for its timing and the fact that the issue waned right after GLOBE agreed to interconnect its short messaging services.

Another development, which has both efficiency and possible anti-competitive implications, is the integration of Internet service into fixed line. Initiated in the country by DIGITEL with its DIGITEL ONE, GLOBE has also introduced Globelines Net Express allowing subscribers to access the Internet and send and receive e-mail without subscribing to any independent Internet Service Provider (ISP). As an example of what convergence offers, the benefits to consumers include convenience (e.g., single billing) and cost savings from not having to pay the flat fees that subscription to independent ISPs usually entail. The implication for competing independent ISPs is that their survival is conditioned on being able to obtain adequate capacity or leased lines, which is in the interest of telcos offering Internet service to deny, restrict or delay. Under RA 7925, telcos are allowed to offer value added service provided that that no cross-subsidization from its utility operations take place and that other value added providers are not discriminated against in rates or denied equitable access to its facilities.

## CONVERGENCE

Indeed, the horizontal and vertical mergers we are witnessing are being driven by technology convergence. In general, technology convergence implies an increasing overlap between the two primary components of the communication process that have traditionally been separated, namely: common carrier “conduit” systems and networks that transmit signals anonymously, and “content”-based information sources and technologies. Various forms of convergence between traditionally separated industry segments include wireless delivery of telephone signals, wireline delivery of television signals, cable television technology, multichannel wireless and satellite video distribution, digital data transmission, and the Internet. Because of technology convergence, market convergence is emerging from both the supply and demand side. On the supply side, the long-standing organizational divisions between technologies, services, and companies are eroding as industry providers across market segments and national boundaries merge while on the demand side, the market responds via increasing interest in and purchase of multimedia services and technologies.<sup>10</sup>

For the Philippine market setting, the immediate concern is whether or not firms are enabled by the current policy environment to respond to the market demands that technology convergence creates. For example, under Sec. 4a of RA 7925, “no single franchise shall authorize an entity to engage in both telecommunications and broadcasting, either through the airwaves or by cable.” In response, proposals have been filed in congress (so-called “convergence bills”) that seek, among other things, to remove cross-sector ownership restrictions.

From the standpoint of competition policy, given the inevitability of supply-side convergence, will the industry be less competitive as a result of the mergers? How will consumers, current and future, be affected and protected? Since mergers are supposed to create efficiencies, then such efficiencies must outweigh the potential harmful effects of increased market power for the mergers to be allowed, even encouraged. In turn, whether or not any detrimental effects can be mitigated will depend on the existence of competitive safeguards.

## REGULATORY COMMITMENTS BY THE PHILIPPINES UNDER WTO

The General Agreement on Trade and Services Reference Paper on Basic Telecommunications prescribes a set of regulatory principles to govern the sector. Specifically, it includes key regulatory requirements to ensure non-discriminatory market access, including competitive safeguards, non-discriminatory interconnection, competitively neutral universal service obligations, independent regulators, and non-discriminatory procedures for the allocation and use of scarce resources. The Reference Paper defined key terms pertaining to competitive safeguards as follows:

Users - service consumers and suppliers

Essential facilities - facilities of a public telecommunications transport network or service

- a) are exclusively or predominantly provided by a single or limited number of suppliers; and

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<sup>10</sup> David N. Townsend, (1997) Regulatory Implications of Telecommunications Convergence ITU Regulatory Colloquium No. 6 (Geneva, Switzerland: International Telecommunication Union), 2-11.

- b) cannot feasibly be economical or technically substituted in order to provide a service.

A major supplier - a supplier that has the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market for basic telecommunications as a result of

- a) control over essential facilities; or
- b) use of its position in the market.

As shown in the following table, the Philippines' commitment based on its revised draft offer does not adopt the specific regulatory principles on competitive safeguards suggested in the Reference Paper. Instead, the Philippine version adopts a general and more flexible language.

TABLE 4. COMPARISON OF WTO REFERENCE PAPER vs. PHILIPPINE COMMITMENT: SECTION ON COMPETITIVE SAFEGUARDS

<b>WTO REFERENCE PAPER SPECIFYING REGULATORY PRINCIPLES</b>	<b>THE PHILIPPINES COMMITMENT ON BASIC TELECOMMUNICATIONS (FEBRUARY 10, 1997)</b>
<p>1. <u>Competitive safeguards</u></p> <p>1.1. <u>Prevention of anticompetitive practices in telecommunications</u></p> <p>Appropriate measures shall be maintained for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anticompetitive practices.</p> <p>1.2 <u>Safeguards</u></p> <p>The anticompetitive practices referred to above shall include in particular</p> <ul style="list-style-type: none"> <li>a) engaging in anti-competitive cross subsidization;</li> <li>b) using information obtained from competitors with anticompetitive results; and</li> <li>c) not making available to other services suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide the services.</li> </ul>	<p>1. <u>Competitive safeguard</u></p> <p>Appropriate measures shall be maintained for the purpose of preventing suppliers from engaging in or continuing anticompetitive practices</p>

Given that the Philippines opted to state its commitment to the principles of competition in such broad terms suggests that either a) specific rules governing market behavior are already in place or b) such specific rules, if they do not yet exist, shall be established.

With regard to interconnection, the primary difference between the Philippine commitment and the Reference Paper is that the former applies its interconnection guidelines to

all suppliers while the latter prescribes the interconnection guidelines specifically with respect to a major supplier.

TABLE 5. COMPARISON OF WTO REFERENCE PAPER vs. PHILIPPINE COMMITMENT:  
SECTION ON INTERCONNECTION

WTO REFERENCE PAPER SPECIFYING REGULATORY PRINCIPLES	THE PHILIPPINES COMMITMENT ON BASIC TELECOMMUNICATIONS (FEBRUARY 10, 1997)
<p>2. <u>Interconnection</u></p> <p>2.1 This section applies to linking with suppliers providing telecommunication transport networks or services in order to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier, where specific commitments are undertaken.</p> <p>2.2 <u>Interconnection to be ensured</u> Interconnection with a major supplier will be ensured at any technically feasible point in the network. Such interconnection is provided</p> <ul style="list-style-type: none"> <li>a. under nondiscriminatory terms, conditions (including technical standards and specifications), and rates and of quality no less favorable than that provided for its own like services or for like services of nonaffiliated service suppliers or for its subsidiaries or other affiliates;</li> <li>b. in a timely fashion, on terms, conditions (including technical standards and specifications) and cost-oriented rates that are transparent, reasonable, having regard to economic feasibility, and sufficiently unbundled so that the supplier need not pay for network components or facilities that it does not require for the service to be provided; and</li> <li>c. upon request, at points in addition to the network termination points offered to the majority of users, subject to charges that reflect the cost of construction of necessary additional facilities.</li> </ul> <p>2.3 <u>Public availability of the procedures for interconnection negotiations</u></p>	<p>2. <u>Interconnection</u></p> <p>In order to achieve viable, efficient, reliable and universal telecommunications services, a fair and reasonable interconnection of facilities of authorized public network operators and other providers of telecommunications services shall be provided.</p> <p>Interconnection shall be at any technically feasible point in the network, under non-discriminatory terms and conditions, in a timely fashion, and on terms and conditions that are fair, transparent and reasonable.</p> <p>A service supplier requesting interconnection with another supplier will have recourse after a reasonable period of time which has been made publicly known to an independent domestic body, which may be a regulatory body referred to in paragraph 5 below, to resolve disputes regarding appropriate terms, conditions and rates for interconnection within a reasonable period of time, to the extent that these have not been established previously.</p>

The procedures applicable for interconnection to a major supplier will be made publicly available

2.4. Transparency of interconnection arrangements

It is ensured that a major supplier will make publicly available either its interconnection agreements or a reference interconnection offer.

2.5. Interconnection: dispute settlement

A service supplier requesting interconnection with a major supplier will have recourse, either

- a) at any time or
- b) after a reasonable period of time which has been made public known to an independent domestic body, which may be a regulatory body as referred to in paragraph 5 below, to resolve disputes regarding appropriate terms, conditions and rates for interconnection within a reasonable period of time, to the extent that these have not been established previously.

## THREATS TO COMPETITION

As the experiences of local communities show, despite some problems, consumers are already clear winners as a result of liberalization. Given such gains, is there still a need for a competition policy to govern the sector? The answer stems from two main concerns. Firstly, we want to make sure that such benefits are not temporary. Secondly, we want to be able to enjoy the benefits of competition to its fullest. As long as threats to competition exist and as long as opportunities for increasing consumer welfare exists then there must be continuous efforts to improve the competitive environment and to guard the competitive process.

Before identifying the threats to competition, we must first establish what it is about competition that we want to promote and preserve. From the experience at the local level, what appears to be the most important gain from liberalization is the expansion of consumer choice. And because the consumer has a choice, then firms do their best to influence consumer preference through improved service, wider product offerings and to some extent, lower prices.

Promoting consumer choice does not depend on the number of players per se. Indeed, in a network industry such as telecommunications, too many operators may even cause to diminish the quality of the choices available to the public. From the standpoint of competition policy, what will promote and preserve genuine consumer choice is *the existence of firms that are credible threats to each other*.

Based on our discussions on the industry structure, the regulatory environment and general market environment, the threat to the attainment of credible competition can be stated simply as follows: *There are not enough specific rules to govern the conduct of firms. Whatever rules exist only help to preserve the market power of a dominant operator.* Because of the lack of explicit rules and the incidence of asymmetric regulation then a firm can engage in exclusionary actions that harm rivals, which if unabated will induce the exit of competition.

### LACK OF EXPLICIT RULES

It is a common expression that the devil is in the details but in this case it is really the lack of details that undermines the essence of competition. In particular, there are two elements of competition policy that we need to define for the Philippine telecommunications sector right now.

#### 1. What is our policy on access?

One important element of competition policy is access to essential facilities (also known as bottleneck facilities). An essential facility is considered such because it is *necessary to a competitor's survival*.

It is deemed important for effective competition in telecommunications because it is not easy and also not efficient to duplicate certain facilities within a reasonable timeframe. Supposing that an IGF operator wishes to deliver an international call then in order to deliver and complete the service, it would be better to use the existing access line of the subscriber than to install a second line to transport the message.

The WTO reference paper prescribes interconnection guidelines specifically for *essential facilities* and for *major suppliers* in recognition of the size to which their networks have grown as a consequence of the monopoly position that they have enjoyed for decades. Unless other operators obtain timely access to the networks of incumbents under non-discriminatory terms and conditions and at cost-oriented rates then they will not be able to receive the benefits of liberalization as advocated in the WTO. However, to the extent that new entrants can feasibly and efficiently duplicate the facilities then such are no longer considered essential.<sup>11</sup> Thus, such guidelines are really intended to facilitate the entry of competition and to support them at the early stages of market entry. Same obligations for access are not imposed on carriers other than a major supplier because to do so would limit the flexibility of new competitors.

In addition to not providing new entrants in basic telephone service with the support needed to accommodate their entry, our lack of explicit policy on access for the rest of the sector also leads us to apply interconnection indiscriminately thereby hurting the spirit of competition. A case in point is the GLOBE-SMART interconnection of short messaging service. Whereas interconnection is required (i.e., essential) for vertically related services in order for the full service to be completed, to require the same or on the same terms for parallel services is anti-competitive. Such decision robs an innovator or first-mover of the rewards from risk-taking. In the end, it is the consumer that is adversely affected because consumer choice is constrained in a market environment that does not provide incentives for firms to innovate or initiate.

## 2. What is our policy on vertical and horizontal mergers?

A policy on mergers entails the setting of guidelines that would trigger an inquiry on whether or not a proposed merger will reduce competition *after* the merger takes place. For example, pre- and post-merger market shares or industry concentration are compared to determine if a proposed merger should go unchallenged or not. If challenged, further inquiries would need to be undertaken to determine if the merger should be allowed. As mentioned earlier, mergers create efficiencies particularly for the firm. However, efficiencies alone do not provide justification for a merger and specific benefits accruing to society must be identified and weighed against other effects to determine the merits of a merger. For example, what may be required is to demonstrate that the merger will result in lower prices or at least not lead to an increase.

For the case of vertical integration, anti-competitive behavior can take the form of foreclosure (i.e., when a competitor is denied access to a monopoly segment controlled by the vertically integrated firm), a price squeeze (i.e., access charges are so high as to reduce a competitor's margins) or price discrimination (i.e., monopoly rents from the utility operations are used to subsidize to lower prices in the competitive lines of business). All these actions are considered exclusionary or even predatory because they harm rivals and facilitate exit. Once exit takes place then the surviving firm can exercise absolute market power. Again, consumers end up as the real losers because their choices are narrowed down.

To be sure, provisions with regard to such anti-competitive behavior are already spelled out in RA 7925 (e.g., VAS). Implementing Rules and Regulations (IRR) of RA 7925 however do not touch on these issues.

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<sup>11</sup> AT&T (Feb 1998) The Requirements of the GATS Reference Paper, (unpublished monograph), 2

## ASYMMETRY IN REGULATION IN FAVOR OF DOMINANT OPERATOR

There are a couple of regulations that work against the creation of genuine competition in the sector. The first imposes an additional cost to entrants but not to the dominant operator. The second deprives competition of opportunities to exploit economies of scale and scope. It also deprives competition of the opportunity to generate network externalities.

### 1. Universal access strategies

New entrants were required to install a fixed number of lines as a condition for entry. CMTS operators had to install 400,000 lines while IGF operators were required to put up 300,000 lines in underserved and unserved areas. In contrast, the incumbent dominant operator PLDT was never subjected to any such requirement. Clearly, such rule constitutes a barrier to entry. That firms still entered the market despite the existence of such barrier does not reduce its detrimental effect on competition and consumers.

How are consumers hurt by such an unequal cost burden? The imposition of additional cost to entrants can help mask any inefficiency on the part the dominant operator. Also, a particular firm may be an efficient CMTS operator only or an efficient IGF operator only. Forcing firms to provide another service deprives consumers of the benefits of specialization.

Although most carriers have already satisfied this requirement, universal service obligations is still relevant to the issue of competition because of the use of the access charge as a tool for subsidizing local exchange service. As discussed earlier the access charge must not only reflect the actual cost of interconnection but is also supposed to contain a subsidy component. *That the access charge is used as an instrument for the universal access goals of the government exacerbates the asymmetry between firms.* PLDT, despite not having to install a line in an unserved or underserved area, imputes a subsidy component into the access charge for its local exchange.

### 2. Assignment of service areas

Another factor that works against the creation of a credible threat to the dominant operator is that fringe operators are constrained by the regulator to operate only within certain jurisdictions. As a result, their ability to develop economies from both the supply and demand side is constrained. Supply side economies imply that a firm can take advantage of common inputs so that costs per line are reduced. Therefore, one firm providing the service in areas A and B can be more efficient than two firms operating in each area. Demand side economies mean that one's subscribers can easily access a wider network of subscribers (i.e., from different parts of the country), which attracts even more subscribers to join. Naturally, a firm that enjoys both such economies can have a better bargaining position vis-à-vis the dominant firm.

In summary, the current market environment does not bode well for competition and thus, nor for consumer welfare. There is a false sense of fairness in the lack of explicit rules to govern how firms, particularly a dominant firm, are supposed to compete because it ignores the inherent asymmetry between incumbents and new entrants. That certain regulations handicap new entrants even further only serve to impede the creation of genuine competition in the Philippine telecommunications sector.

## RECOMMENDATIONS

What can be done to ensure a contestable<sup>12</sup> Philippines telecommunications sector? Our recommendations are based on the following assumptions:

- The regulator alone cannot provide the necessary countervailing power against market power.<sup>13</sup>
- We have to work within the policy framework of RA 7925, which specifies that:
  - Access charges are to be negotiated (Article VI Sec. 18),
  - The access charge is supposed to make provision for the cross subsidy to unprofitable local exchange service areas (*and not to local exchange per se*) (Article III. Sec. 5 c), and
  - The NTC can exempt any specific telecommunications service from its rate or tariff regulation if the service has sufficient competition to ensure fair and reasonable rates or tariffs. (Article VI Sec. 17)
- Most entrants have already complied with the mandate to install lines.

With the aforementioned as givens, it is recommended that steps be taken to distribute market power and create an environment that prevents the exercise of monopolistic behavior. Concretely, this would entail the following:

Firstly, that we establish specific rules to govern firm behavior. In particular, policies on access to essential facilities and mergers discussed earlier must be defined.

Secondly, a second national license (i.e., the LEC can operate anywhere in the Philippines just like PLDT) must be granted to facilitate consolidation and the formation of second carrier that can pose a credible threat to the current dominant operator.

Thirdly, improve regulation by privatizing certain functions such as auditing performance of operators, preparing public consultation documents or implementing alternative dispute resolution mechanisms.<sup>14</sup> This would make important information readily available to consumers, firms, and even the regulator. It also enhances the process of regulation. Of course, rule making (i.e., regulatory authority) would still rest with the NTC.

The first three suggestions stem from our concern the regulator alone cannot be expected to perform the role of a “countervailing power”. Therefore, this function must be shifted to the

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<sup>12</sup> Strictly speaking, the requirements of contestability (e.g., zero sunk cost) do not apply here. We use the term loosely to mean that firms behave as if credible competition, actual or potential, exists.

<sup>13</sup> For this assumption the reader is referred to Jacinto Gavino, Jr. (1992) “A Critical Study of the Regulation of the Telephone Utility: Some Options for Policy Development” (Ph.D. diss., University of the Philippines) which discusses the weaknesses of the NTC under monopoly regulation and to Ramonette B. Serafica (1998). “Beyond 2000: An Assessment of Infrastructure Policies” *Discussion Paper Series 98-07* (Makati: Philippine Institute for Development Studies) which argues that the demands on the regulator under the new liberalized environment are even greater.

<sup>14</sup> Peter Smith (1997) “What the Transformation of Telecom Markets Means for Regulation,” Public Policy for the Private Sector Note No. 121 (Washington, D.C.: The World Bank Group)

market itself, distributing power not only among firms but also between the two sides of the market – the suppliers and the consumers.

Fourthly, the access charge must only serve one objective and that is to accommodate competition. The implication in terms of the level and structure of the access charge is that the rates must reflect only the cost of interconnection with no provision for universal access goals. Given the requirement in RA 7925, subsidy should go only to unprofitable areas. The argument that access charges based on the incremental cost of interconnection will not encourage network build-out is not relevant for the Philippine case because of the forced roll out earlier implemented. Therefore the more appropriate access-pricing regime for the country at this point (i.e., post-SAS) is one that facilitates competition rather than network build-out.

Finally, end-user price setting by the regulator must eventually be removed. There is no way that the regulator can determine the “right” price in an increasingly convergent environment. Firms must be accorded greater flexibility in structuring their prices. Fear of cartel-like behavior can be addressed as long as pro-competitive policies are expanded and strengthened. Thus, although initially focus must be on curtailing market power by a single firm, rules to prevent collusion must be established before price regulation is completely relaxed.

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## APPENDIX A

### Dominant firm per province

REGION	PROVINCE	DOMINANT FIRM	MARKET SHARE OF DOMINANT FIRM	OTHER OPERATORS
CAR A	Abra	DIGITEL	54%	SMART
	Benguet	PILTEL	74%	SMART, PLDT, DIGITEL
	Mt. Province	SMART	78%	DIGITEL
CAR B	Kalinga-Apayao	DIGITEL	100%	None
	Ifugao	DIGITEL	100%	None
Region 1	Ilocos Norte	PLDT	49%	SMART, DIGITEL
	Ilocos Sur	DIGITEL	86%	SMART
	La Union	PLDT	51%	Northern Tel. Co., SMART, DIGITEL
	Pangasinan	DIGITEL	80%	Nortelco, SMART, San Carlos Tel. Co., PLDT
Region 2	Batanes	None	0	None
	Cagayan	PLDT	76%	DIGITEL
	Isabela	DIGITEL	100%	None
	Quirino	DIGITEL	100%	None
	Nueva Vizcaya	DIGITEL	100%	None
Region 3	Bataan	PLDT	58%	Battlex, DIGITEL, OWNI, SMART
	Bulacan	DIGITEL	56%	SMART, PLDT, Datelcom Corp.
	Nueva Ecija	PLDT	46%	SMART, DIGITEL
	Pampanga	DIGITEL	34%	Datelcom, SMART, PLDT, Pampanga Tel. Co.
	Tarlac	PLDT	90%	SMART
	Zambales	DIGITEL	73%	SMART, PLDT
Region 4 A	Aurora	None	0	None
	Laguna	PLDT	49%	DIGITEL, Banahaw Tel. Co., PT&T, Intelco, CTSI
	Marinduque	DIGITEL	100%	None
	Quezon	Gen. Tel. Sys.	38%	Lukban Tel. Sys, PLDT, Santos Tel. Sys, Cruztelco., DIGITEL
	Rizal	PLDT	45%	PT&T, DIGITEL
	Romblon	Romblon T. C.	100%	None

REGION	PROVINCE	DOMINANT FIRM	MARKET SHARE OF DOMINANT FIRM	OTHER OPERATORS
Region 4 B	Batangas	PLDT	44%	CTSI, GLOBE, West. Bat. Tel. Sys., DIGITEL
	Cavite	PLDT	44%	GLOBE, DIGITEL
	Occidental Mindoro	DIGITEL	100%	None
	Oriental Mindoro	Calapan Tel. Sys.	76%	GLOBE, RMC Tel Con. Inc.
	Palawan	None	None	None
Region 5	Albay	BAYANTEL	71%	BICOL TP. & TG., INC., DIGITEL
	Camarines Norte	DIGITEL	50%	BAYANTEL, Santos Tel. Sys, Labo Tel System
	Camarines Sur	BAYANTEL	55%	Iriga Tel. Co., LM United TCI, Bicol Rural Tel, DIGITEL
	Catanduanes	DIGITEL	100%	None
	Masbate	None	None	None
	Sorsogon	DIGITEL	82%	BTTI
Region 6	Aklan	Panay Tel. Co.	62%	PLDT, Cruztelco
	Antique	ISLACOM	100%	None
	Capiz	PLDT	88%	ISLACOM
	Guimaras	None	0	None
	Iloilo	ISLACOM	65%	PLDT, S. Iloilo Tel. Co., Pantelco
	Negros Occidental	ISLACOM	50%	PLDT, SN Carlos Tel. Sys., Victorias Tel. Sys.
Region 7	Bohol	PLDT	51%	ISLACOM, Cruztelco.
	Cebu	PLDT	63%	TMSI, ISLACOM, Danao Tel. Co.
	Negros Oriental	ISLACOM	49%	Cruzelco, PLDT
	Siquijor	ISLACOM	76%	TMSI
Region 8	Eastern Samar	None	0	None
	Leyte	ISLACOM	100%	None
	Northern Samar	None	0	None
	Samar	None	0	None
	Southern Leyte	ISLACOM	100%	None
	Biliran	None	None	None
Region 9	Basilan	None	None	None
	Zamboanga del Norte	Cruzelco	100%	None
	Zamboanga del Sur	PLDT	71%	Ipil Tel. Sys., Cruztelco

<b>REGION</b>	<b>PROVINCE</b>	<b>DOMINANT FIRM</b>	<b>MARKET SHARE OF DOMINANT FIRM</b>	<b>OTHER OPERATORS</b>
Region 10	Bukidnon	Southern Tel. Co.	52%	PHILCOM
	Camiguin	Camiguin Tel. Coop.	80%	Camteco
	Misamis Occidental	PLDT	81%	TMSI, Cruztelco
	Misamis Oriental	PHILCOM	56%	Italtel, Sotelco, Misortel, Cruztelco
Region 11	Davao	PHILCOM	43%	Cruztelco, Datelco Global CI, PLDT
	Davao del Sur	PLDT	100%	None
	Davao Oriental	PHILCOM	63%	Mati Tel. Co.
	South Cotabato	Marbel	100%	None
	Sarangani	None	0	None
	Compostela Valley	None	0	None
Region 12	Lanao del Norte	Maranao Tel. Co.	87%	TMSI, GLOBE
	Cotabato	M. Kidapawan Tel.	60%	GLOBE, Midsayap Com. Sys.
	Sultan Kudarat	Sultan Kudarat TS	100%	None
Region 13	Agusan del Norte	Cruztelco	55%	PHILCOM
	Agusan del Sur	PHILCOM	62%	Cruztelco
	Surigao del Norte	Cruztelco	55%	PHILCOM
	Surigao del Sur	PHILCOM	84%	PLDT
ARMM	Lanao del Sur	None	0	None
	Marawi City	None	0	None
	Maguindanao	PLDT	95%	GLOBE
	Sulu	Jolo TS	100%	None
	Jolo	None	0	None
	Tawi-tawi	None	0	None
	Bongao	None	0	None
NCR A	Manila	PLDT	100%	ETPI, BAYANTEL
	Caloocan	PLDT	100%	ETPI
NCR B	Quezon City	PLDT	57%	BAYANTEL
	Valenzuela	PLDT	51%	BAYANTEL
	Malabon	PLDT	64%	BAYANTEL

<b>REGION</b>	<b>PROVINCE</b>	<b>DOMINANT FIRM</b>	<b>MARKET SHARE OF DOMINANT FIRM.</b>	<b>OTHER OPERATORS</b>
NCR C	Makati	PLDT	84%	GLOBE
	San Juan	PLDT	94%	GLOBE
	Mandaluyong	PLDT	72%	GLOBE
	Marikina	PLDT	84%	GLOBE
	Pasig	PLDT	83%	GLOBE
NCR D	Las Pinas	PLDT	100%	SMART
	Paranaque	PLDT	68%	SMART
	Pasay	PLDT	56%	SMART
	Taguig	SMART	100%	None
	Muntinlupa	PLDT	55%	SMART

**NOTE - COMPUTATION OF MARKET SHARE BASED ON REPORTED 1998 SUBSCRIBED LINES ONLY  
SOURCE: NATIONAL TELECOMMUNICATIONS COMMISSION**

## APPENDIX B

### RA 7925 : Relevant Provisions on Interconnection

Article III. Sec. 5 c (the Commission shall) Mandate a fair and reasonable interconnection of facilities of authorized public network operators and other providers of telecommunications services through appropriate modalities of interconnection and at a reasonable and fair level of charges, which make provision for the cross subsidy to unprofitable local exchange service areas so as to promote telephone density and provide the most extensive access to basic telecommunications services available at affordable rates to the public;

Article VI Sec. 18 Access Charge/Revenue Sharing – The access charge/revenue sharing arrangements between all interconnecting carriers shall be negotiated between the parties and the agreement between the parties shall be submitted to the Commission. In the event the parties fail to agree thereon within a reasonable period of time, the dispute shall be submitted to the Commission for resolution.

In adopting or approving an access charge formula or revenue sharing agreement between two or more carriers, particularly, but not limited to a local exchange, interconnecting with a mobile radio, inter-exchange long distance carrier, or international carrier, the Commission shall ensure equity, reciprocity and fairness among the parties concerned. In so approving the rates for interconnection between the telecommunications carriers, the Commission shall take into consideration the costs of the facilities needed to complete the interconnection, the need to provide the cross-subsidy to local exchange carriers to enable them to fulfill the primary national objective of increasing telephone density in the country and assure a rate of return on the total local exchange network investment that is at parity with those earned by other segments of the telecommunications industry: *Provided*, That international carriers and mobile radio operators which are mandated to provide local exchange services, shall not be exempt from the requirement to provide the cross-subsidy, when they interconnection with the local exchanges of other carriers: *Provided, further*, That the local exchanges which they will additionally operate, shall equally be entitled to the cross-subsidy from other international carriers, mobile radio operators, or inter-exchange carriers interconnecting with them.

RA 7925 IMPLEMENTING RULES AND REGULATIONS: RELEVANT PROVISIONS  
ON INTERCONNECTION

RULE 520 ACCESS CHARGES

GENERAL

- (a) Until the local exchange service is priced reflecting actual costs, the local exchange service shall be cross-subsidized by other telecommunications services.
- (b) The allocation of the local exchange carrier costs to all interconnect services including those offered by the same company operating the LE service shall be based on actual cost of interconnection.
- (c) The subsidy needed by the LE service operator to earn a rate of return at parity with the other segments of telecommunications industry shall be charged against the international and domestic toll and CMTS interconnect services
- (d) The Cost Manual shall follow the accounting structure based on the applicable provision of US Federal Communications Commission (FCC) Part 36 as modified to confirm with the provisions of this Circular.
- (e) Provision for doubtful accounts (as used in general accounting) shall not be included in the costs.
- (f) Only taxes actually incurred shall be included in the costs.
- (g) The access charge shall be negotiated by the interconnecting parties. In the event the parties cannot arrive at an agreement, either or both parties can bring the matter before the Commission for final action pursuant to NTC MC 9-7-93
- (h) Interconnecting parties shall strictly adhere to the herein prescribed guidelines.
- (i) The cost manual shall be submitted to the Commission not later than 31<sup>st</sup> of July of each year for approval. In approving the cost manual, the Commission shall consider efficiency and the "Philippine Best Practice".
- (j) The interconnection between CMTS and local exchange network for purposes of calculating the access charge shall be considered domestic toll interconnect.
- (k) Reappraisal of plant and facilities in service shall be duly approved by the Commission after due notice and hearing.
- (l) Actual costs and all accounting charges for provisioning of services and interconnection shall be non-discriminatory, transparent, de-averaged by time of day and unbundled, and subject to review by the Commission.
- (m) Interconnection charges shall be composed of the access charge and the subsidy. For the purpose of calculating the subsidy, the local exchange networks shall be classified into three (3), to wit: Metro Manila, Highly Urbanized Cities defined by law and Others
- (n) Interconnection charges shall accrue only on completed calls.

COST SEPARATION

- (o) A LE service provider operating other telecommunications services shall separate the cost at discrete and recognizable point(s) of demarcation for each of the services it offers to determine the cost of the local exchange service.
- (p) Direct assignment of costs to each services category when possible will be made.
- (q) Actual costs basis of separation which gives consideration to relative usage/circuit occupancy of services for traffic related costs shall be used.

- (r) Costs of customer billing of toll services shall be allocated fully to the local exchange service.
- (s) Cost of marketing and advertising shall not be allocated to the local exchange service.

#### ALLOCATION OF COSTS

- (t) The local exchange service costs shall be shared by the interconnect services as follows:

- The cost allocated/charged to the local exchange service shall be equivalent to the local exchange service gross revenue plus the revenues derived from the interconnection services other than international and domestic toll and CMTS

- The cost allocated/charged to the interconnection services other than domestic and international toll and CMTS shall be based on the actual cost of interconnection

- The cost allocated/charged to the international and domestic toll and CMTS interconnection services shall be divided into two components, to wit: access charge and subsidy. The access charge shall be based on the actual costs of interconnection while the subsidy shall be equal to the revenue required by the LE operator to earn a rate of return at parity with those with those earned by other segments of the telecommunications industry.

- Interconnection services shall also include all telecommunications services offered by the PTE interconnected to the local exchange network, operated by the same PTE.

#### INTERCONNECTION OF LOCAL EXCHANGE NETWORKS

- (u) There shall be no access charges to be paid by either party in the interconnection of local exchange networks operating in a given local exchange service area if the monthly local exchange service rate is fixed and that the local exchange service operators do not discriminate applicants for local exchange service.
- (v) In the event that in any given local exchange service area there are a mixture of fixed and measured rates, the local exchange service operators thereat shall negotiate for the access charges. In the event the parties cannot agree, the matter may be brought to the Commission for final action pursuant to the MC 9-7-93.
- (w) In the negotiation between the LE service operators, the cost of investment shall be considered.