

Unclassified

DAF/COMP/GF/WD(2012)9



Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

15-Dec-2011

English - Or. English

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

**DAF/COMP/GF/WD(2012)9
Unclassified**

Global Forum on Competition

COMPETITION AND COMMODITY PRICE VOLATILITY

Contribution from the Philippines

-- Session I --

This contribution is submitted by the Philippines under Session I of the Global Forum on Competition to be held on 16 and 17 February 2012.

JT03313462

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COMPETITION AND COMMODITY PRICE VOLATILITY

-- Philippines* --

1. A Paper on Flour: Background

1. The increasing prices in the recent years especially food have caused serious concerns around the world. Global prices have been rising brought about by different factors. Consumers are already battling to cope with the increase in prices especially on food.

2. The Philippines is among the countries that is experiencing the effect of the increasing food prices. One of the commodities which have drawn the attention of the agency because of its price volatility is flour.

3. Flour is one of the commodities that have been considered as volatile in the Philippines. Price of flour heavily depends on the cost of imported wheat, the major cost component in the production. Other factors such as: foreign exchange rate, freight and local raw materials used in the production of flour also affect the price of flour in the market.

4. This paper will focus on the effect of the fluctuating price of wheat on the price of locally milled flour. It aims to provide an overview of the flour milling industry in the Philippines and the price movements of flour in relation to wheat. It also includes the actions undertaken by the government particularly the Department of Trade and Industry (DTI) to address the increasing prices of commodities such as flour and bread.

5. For this study, DTI utilized the data on monthly prices of hard flour to represent the variable flour price and price of hard spring wheat for wheat price. Price of Wellington hard flour that will be used in this paper will be based on the monitored prevailing prices in the National Capital Region and price of hard spring wheat is based on the data of the US Wheat Associates.

1.1 Flour

6. Flour is a finely ground powder prepared from grain or other starchy plant foods and used in baking. There are two types of flour: hard flour which is used in making high-rise bread like pan de sal and loaf; soft flour which is used in pasta, and cookies among others.

7. Although flour can be made from a wide variety of plants, the vast majority is made from wheat. Wheat is the most important crop among the cereals by area planted. Most wheat is consumed in the form of baked goods, mainly bread; therefore wheat grains must be milled to produce flour prior to consumption.

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8. The movement in the price of wheat had greatly influenced the price of flour in which in turn affects also the price of loaf breads and pan de sal. The pricing and supply of flour has drawn the attention of the government throughout the years.

9. In the international wheat market, the U.S. wheat producer is regarded as one of the most innovative and productive in the world. Currently, more than half of the U.S, wheat produced is exported to overseas customers. ¹

10. Wheat is grown in most of the 50 states of the United States. The kind of wheat grown and the quantity vary widely from one region to another. Wheat has two distinct growing seasons: winter wheat and spring wheat. The many varieties of winter and spring wheat are classified into six classes. Wheat classes are determined by its hardness, the color of its kernels and by planting time. Each class has its own uniform characteristics related to milling, baking or other food use. ²

1.2 *Types of Wheat*

- Hard Red Winter (HRW)-bread wheat which accounts for nearly half of US production.
- Hard Red Spring (HRS)-bread wheat that have good milling and baking characteristics and has the highest protein content, usually 13-14%.
- Hard White (HW) - used for noodles, yeast breads and flat breads. It is used primarily in domestic markets with limited quantities being exported.
- Soft White (SW) - preferred wheat for flat breads, cakes, pastries, crackers and noodles. It is a low protein wheat usually about 10%.
- Soft Red Winter (SRW) - high yielding wheat, but relatively low in protein, usually about 10%. It is used for cakes, pastries, flat breads, crackers and snack foods.
- Durum- the hardest of all U.S. wheat which provides semolina for spaghetti, macaroni and other pasta products. ³

1.3 *The Flour Milling Industry*

11. Republic Flour Mills (RFM), the first milling company in the Philippines started its operation in 1958. It was established to address the need of the country to be self-sufficient in a basic food commodity like flour. RFM was the pioneer of the flour-milling industry in the Asian region and it evolved from a single company producing bags of flour, to a multi-company enterprise managing a chain of branded products. Its first flour mill is located on a seven-hectare land in Mandaluyong, Metro Manila.

12. Because of the success of the Republic Flour Mills, competitors were attracted to join the flour milling industry. At present, there are twelve companies engaged in the manufacturing of flour which is affiliated with two industry organizations namely the Philippine Association of Flour Millers (PAFMIL) and the Chamber of Philippine Flour Millers (CHAMPFLOUR). PAFMIL is composed of RFM, Liberty Flour Mills, Wellington Flour Mills, Pilmico Foods Corporation, General Milling Corporation, Universal

¹ From Farm to Port: U.S. Wheat Information, 27 August 2007 from 67.212.164.118/assets/pdf/farm_to_port.pdf

² Ibid.

³ Ibid.

Robina Corporation and the Philippine Flour Mills. CHAMPLOUR on the other hand is composed of San Miguel Mills, Philippine Foremost Milling Corporation, Morning Star Milling Corporation and Delta Milling Corporation.

- **Liberty Flour Mills** – a stock corporation incorporated in 1958, engaged in the business of manufacturing of various kinds of bakery flour and flour related products. Its flour products include El Superior and LFM Bakers which is flour used for making bread, Pine Tree and LFM Soft Flour used for the manufacture of biscuits and cookies, and Maya all-Purpose Flour.
- **Wellington Flour Mills**- started its operation in February 1360. Its brands are Wellington and Doña Salustiana and Filipina.
- **Pilmico Foods Corporation**- Pilmico Foods Corporation started operating in 1962 engaged in the manufacture of wheat flour and wheat by-products.
- **General Milling Corporation**-started its operation in Cebu in 1961. Their brand of flour is known as General Flour.
- **Universal Robina Corporation**- traces its beginning all the way back to 1954. In the early 1970s, Continental Milling Corporation was formed for flour milling and production. URC Flour produces and sells Hard and Soft Flour to both commercial and institutional accounts.
- **San Miguel Mills**- produces and markets flour with its mill in Mabini, Batangas. Its brands for flour are: Emperor Premium Bread Flour, Pacific, Emperor Hard Wheat Flour, King Hard Wheat Flour, Monarch Hard Wheat Flour and Count Hard Wheat Flour, Queen Soft Flour and Countess Soft Wheat Flour.
- **Philippine Foremost Milling Corporation**-was established in 1989 and was the first flour mill plant in Western Visayas. Its brands for hard flour are Montana Spring, Dakota Champion, and Washington Gold and for soft flour, Gold Key and Amigo Gold.
- **Morning Star Milling Corporation**- started in 1988 with the objective of producing quality flour and downstream products that were lacking in the Philippine market.

1.4 Price Movements

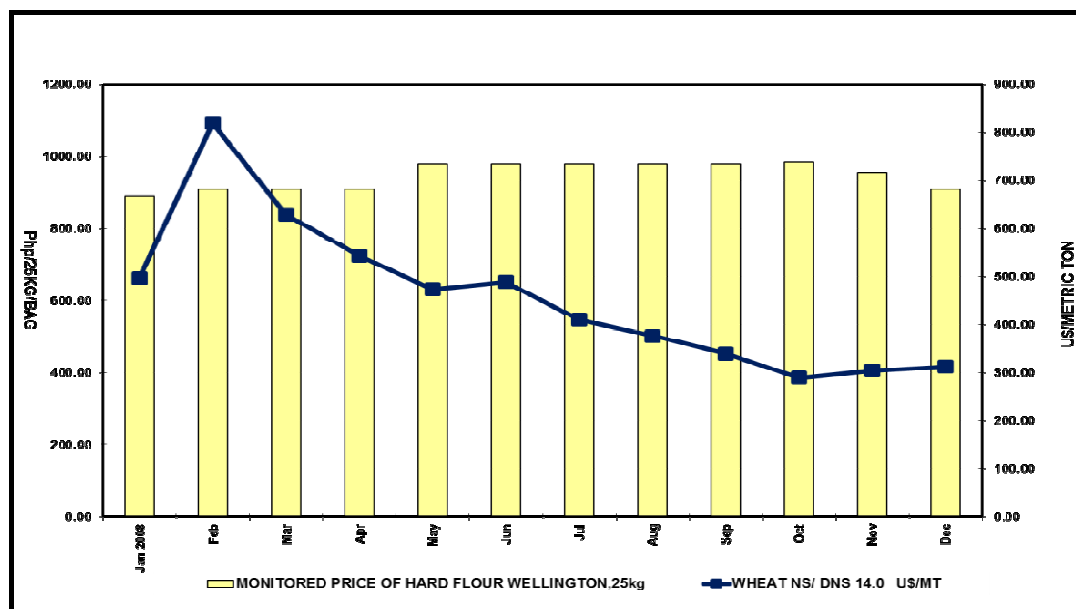
13. According to the flour milling industry, the main sources of wheat are United States, Canada and Australia. It takes 30 days to transport wheat from the source to the Philippines. Upon arrival, it takes another two months before flour is supplied in the market, one month in the silo and another month for the production.

14. Based on the handbook of the agribusiness manuals prepared by the Food and Agriculture Organization (FAO), world prices of wheat nearly doubled over the period 2007-2008 but fell sharply from their records high due to increased production, prompted by earlier price increases and weaker demand combined with the global economic crisis. Due to the irregular shortages in wheat supply, wheat prices have been highly volatile.⁴

⁴ Food and Agriculture Organization: Agribusiness Handbook Wheat, Flour from www.fao.org/docrep/012/al376e/al376e.pdf

15. Any change in the price of wheat in the world market will result to change in the price of flour. Whenever there is a change in the price of flour, it may or may not affect the price of bakery product. According to bakers, for every P40.00 increase in flour prices, there is a corresponding increase of P1.00 in the price of loaf bread and P0.50 cents in a 10-piece pack of pan de sal.

Figure 1. Monthly Prices of Wheat (US\$/mt) and Flour (PhP/25kg bag) in 2008⁵



16. Average price of wheat was US\$497.00/mt in January 2008. It peaked in February 2008, increasing by a hefty 64.79% to US\$819.00/mt.

17. Based on the special report released by the US Wheat Associates, world wheat production increased in 2007/08. With stocks beginning at 14% less than 2006/07 and significant production problems in Canada, Australia and the European Union (EU) and Ukraine, world wheat prices steadily increased. Because of this, many exporting countries closed their doors in an effort to control prices of breads. This further pushed prices of wheat which reached its highest peak in February 2008. Combined with this, demand remained firm brought by higher per capita income in developing countries and the fear of possible shortage. In the midst of high price of wheat and freight rates and weak US dollar, US exports increased to 34.5 million metric tons (MMT), the highest level in 15 years. World trade in 2007/08 increases to 1147MMT, the US accounting for nearly one third of all exports.⁶

18. Price dropped to about half of February's level in August 2008 to US\$376.00/mt following the news that world inventories were set to rise after growers increased seeding to capitalize on rising prices in 2007. From July to December 2008, movement in the price of wheat was on a downward trend. In October 2008, price of wheat was US\$289.00/mt, the lowest price recorded in that year.

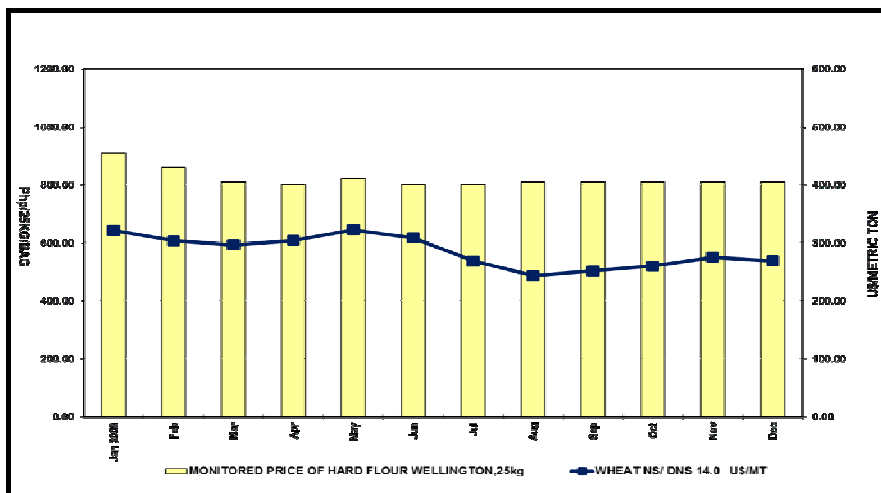
19. Following the peak in the price of wheat in February 2008, monitored prevailing price of Wellington Hard Flour increased from P890 per 25 kg in January 2008 bag to P910.00/bag in February 2008. It increased by 7.69% (P980.00/bag) in May 2008. It again increased by P5.00 (P985.00/bag) in October 2008.

⁵ Source: NCR Monitoring Report 2008 and US Wheat Associates.

⁶ US Wheat Associates: US Wheat Associated Annual Report 2007/08 from 67.212.164.118/assets/pdf/farm_to_port.pdf.

20. Monitored prevailing price of flour fell to P955.00/bag in November 2008 which further declined to P910.00/bag in December 2008.

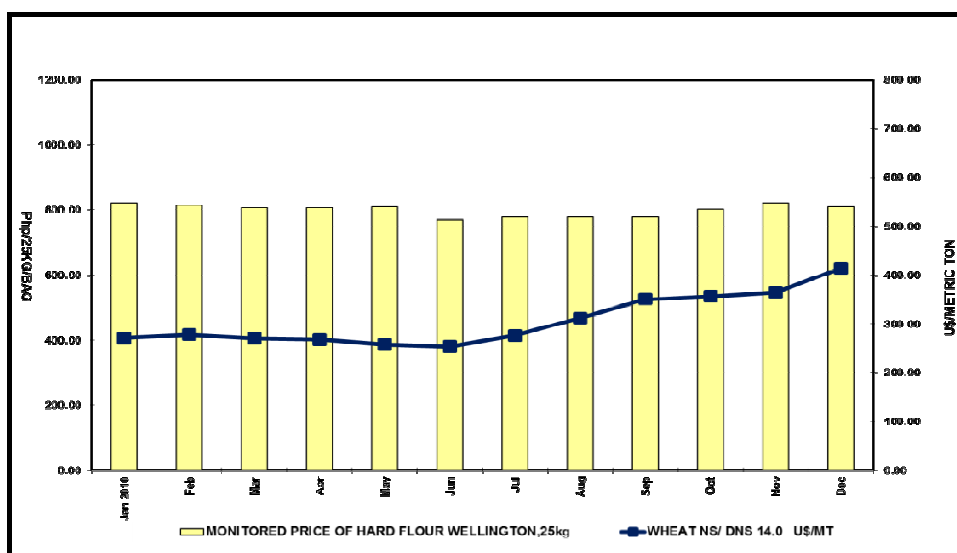
Figure 2. Monthly Prices of Wheat (US\$/mt) and Flour (PhP/25kg bag) in 2009⁷



21. Price of wheat in 2009 was much lower compared to January 2009 at US\$321.00/mt compared in February 2008. In March 2009, price fell down to US\$296.00/mt. It rose to US\$322.00/mt in May 2009. Price fell during the second half ranging from US\$243.00/mt to US\$275.00/mt.

22. From P910.00/bag in January 2009, monitored prevailing price of flour went down to P860.00 in February 2009. Another decrease was noted in March and April at P810.00/bag and P800.00/bag respectively. Price spiked in June at P980.00 and declined to P810.00/bag in September 2009. Price remained at this level until December 2009.

Figure 3. Monthly Prices of Wheat (US\$/mt) and Flour (PhP/25kg bag) in 2010⁸



⁷ Source: NCR Monitoring Report 2008 and US Wheat Associates.

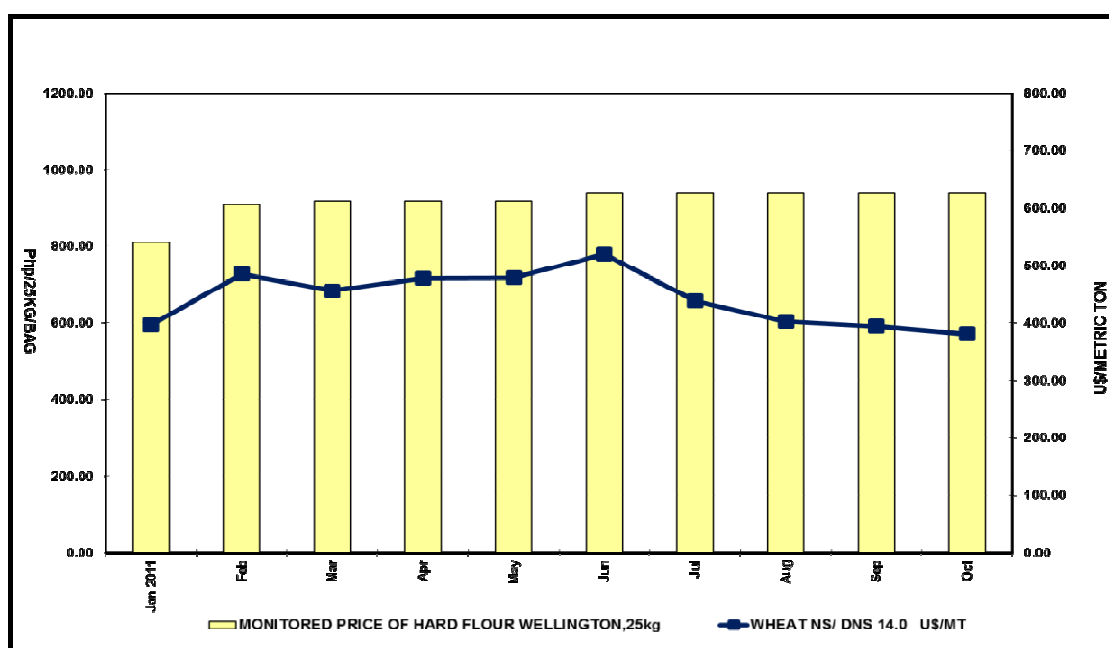
⁸ Source: NCR Monitoring Report 2008 and US Wheat Associates

23. Price of wheat remained to be stable in the seven months of 2010. In January, average price of wheat reached US\$271.00/mt, declined to US\$254.00/mt in July 2010. Price started to increase in August at US\$312.00/mt, which further increased to US\$364.00/mt in November 2010. At the end of the year, price climbed to US\$414.00/mt.

24. The increase in the wheat prices in the middle of the year is a result of the Russian ban on exports after a drought destroyed crops, tightening global supplies.

25. From P810.00/bag in January 2010, monitored prevailing price of flour decreased to P780.00/bag in April 2011 and P770.00/bag in July 2010. As a result of the price hike in wheat in August 2010, price of flour went up to P805.00/bag. Price of flour further increased recording a P820.00/bag at the end of the year.

Figure 3. Monthly Prices of Wheat (US\$/mt) and Flour (PhP/25kg bag) in 2010⁹



26. For 2011, price of wheat remained to be high at US\$396.00/mt in January. Price increased to US\$485.00/mt in February 2011 but decreased to US\$478.00/mt in April 2011. Price rallied to US\$519.00/mt in June 2011. It decreased to US\$402.00/mt in August and US\$381.00/mt in October 2011.

27. Monitored prevailing price of Wellington Flour was P810.00/bag in January 2011. It went up to P920.00/bag in March 2011. This price remained until May 2011. In June 2011 price climbed to P940.00/bag. Despite the decrease in the price of wheat in August and October, price of flour remains at P940.00/bag.

⁹ Source: NCR Monitoring Report 2008 and US Wheat Associates

2. Competition Law Enforcement & Formal Investigation

2.1 Reduction in the Duty of Imported Wheat

28. Following the continued increases in the price of flour in 2008, bakers petitioned to DTI to restrain flour millers from further increasing the price of flour. They requested DTI to take steps to stop any further increase on the price of flour since the price of wheat in the world market has decreased.

29. As early as the first quarter of 2008, the three Baker's Associations namely: the Philippine Baking Industry Group, Inc. (Philbaking), the Filipino Chinese Bakery Association, Inc. (FCBAI) and the Philippine Federation of Bakers Association, Inc. (PFBAI) and flour importers appealed for the lifting of tariff on imported wheat and flour. This was triggered by the continuous increase in the price of wheat which pushed the prices of flour up.

30. Because of this situation, President Gloria Macapagal signed Executive Order 765 entitled ***Temporarily Modifying the rates of import duty on wheat under Section 104 of the Tariff and Customs Code of 1978*** on 7 November 2008. In the said EO, tariff rate of wheat was reduced to 0% for a period of six months. This is to stabilize the price of bread and other baked products and to prevent technical smuggling of wheat. It took effect on 21 December 2008 and ended in June 2009.

31. Upon the implementation of EO 765, decreases in the prices of locally milled flour were observed.

32. The Philippine Association of Flour Millers, Inc. (PAFMIL) requested for the extension of the 0% tariff of wheat for another six months or until December 2009. According to the flour millers, this extension will cushion the country from increasing bread prices once the 3% tariff is reimposed due to the continuing crisis in the world economy and it will allow the consumers continued access to high quality, reasonable priced flour milled from wheat grains imported at zero.

33. The tariff commission thru the Tariff and Related Matters (TRM) Committee in which the DTI is the Chairman conducted a review to determine if there is a need to extend EO 765. Flour millers claimed that the 0% tariff on wheat resulted to lower prices of flour and bakery products.

34. The Committee recommended the extension of the zero duty on wheat for duration of another six (6) months. The NEDA Board approved the recommendation of the TRM on 07 July 2009 and Executive Order No. 818 entitled ***“Extending the Effectivity of the Zero Rate of Import Duty on Milling Wheat Under Section 104 of Presidential Decree No. 1464, otherwise known as the Tariff and Customs Code of 1978”*** was signed on 10 July 2009. The EO aims to help stabilize the prices of bread and flour-based products.

35. On 26 January 2010, the TRM endorsed to the NEDA board their recommendation to implement the zero duty on wheat for another six (6) months, subject to further review. This supports efforts to lower the cost of producing wheat flour thereby stabilizing the prices of bread and other bread products. It will also help temper price hikes on bread and bread products arising from increases in the cost of other inputs.

36. EO 863 was signed in 19 February 2010 and expired on 26 August 2010.

37. The Department of Trade and Industry thru the Board of Investments (BOI) in coordination with Bureau of Trade Regulation and Consumer Protection (BTRCP) was tasked to make a study on the extension of the zero tariff on wheat under EO 863. The findings of the study which was conducted on September 2010 were the following:

- Prior to the implementation of EO 765 in November 2008, the price of wheat was already on the downward trend, however, monitored price of flour continued to increase.
- EO 765- The price of wheat was stabilizing at the level of September 2008. This was accompanied by a downward trend in the price of locally milled flour.
- EO 818- The prices of wheat were at relatively low levels (considering the period of study). However, it can be observed that the prices of locally milled flour were moving upwards during this period.
- EO 863- Lowering in the prices of wheat up to the month of June 2010 was noticed. Similar movement was noticed in the prices of flour. Starting July 2010, prices of wheat picked up and a corresponding increase in the price of locally milled flour was observed.

38. On the impact of prices of flour on bread, the following findings were noted:

- EO 765- the price of 25 kg bag of Hard Flour Wellington decreased from a high of P985.00 in October 2008 to P910.00 in December 2008. A decrease in the ex-mill price was also noted, from P945.00 to P930.00. However, no change in the price of a 400g loaf bread was observed.
- Significant drop in prices of flour was noted in 2009. From P910.00 in January 2009, price went down to P880.00 in June 2009. Despite this decrease, the price of a 400g loaf bread increased from P38.00 to P41.00.
- EO 818- The price of Wellington Hard Flour increased from P800.00 in July 2009 to P820.00 in January 2010. While the ex-mill price and the price of loaf bread remained at P790.00 and P41.00 respectively.
- EO 863- The price of Wellington Hard Flour decreased from P815.00 in February 2010 to P780.00 in September 2010. The price of loaf bread increased from P41.00 to P42.50.

39. During this period, the price of sugar, another major component of bread also recorded an upward trend. Considering the rising prices of wheat and sugar, BOI recommended that the zero tariff on wheat be extended.

40. The TRM approved the extension of 0% tariff on milling wheat on 30 September 2010 and endorsed it to the Cabinet TRM. The Cabinet TRM approved the recommendation and endorsed it to the NEDA Board on 28 October 2010.

41. EO 21 or “Reducing the Rate of Import Duty on Milling (Food) Wheat to Zero Under Section 104 of Presidential Decree No. 1464, otherwise known as the Tariff and Customs Code of 1978 as amended, as provided for under Section 3 of EO NO. 863, Series of 2010 was signed on 14 January 2011.

2.2 Profiteering

42. On 11 May 2010 in a news article published in the Manila Bulletin, entitled “Bakers bat for reduction in flour prices”, bakers pressed for the reduction in the price of locally milled flour by as much as P170/bag as price of wheat in the international market went down to US\$300/MT. Bakers said that the price reduction in flour would lead to a rollback in the price of bread and pan de sal.

43. The average price of wheat decreased by 3.25% from US\$277/mt in February 2010 to US\$268/mt in April 2010. The ex-mill price of Wellington Flour remained at P790.00/bag from March 2009 to May 2010. Monitored prevailing price decreased by 1.83% from P820.00/bag in January 2010 to P815.00 in February 2010. It remained at P805.00/bag from March to May 2010.

44. Compared to 2007, the price of wheat in January 2007 was US\$219/MT which fluctuated and increased up to US\$277/MT in August 2007. The ex-mill price of Wellington flour in 2007 was P610.00 from January 2007 to February 2007 and P620.00 from March 2007 to August 2007. On the other hand, the monitored prevailing price was P630.00/bag from January 2007 to February 2007 and P640.00/bag from March 2007 to August 2007. Compared to the current prices of flour with a zero Tariff on wheat, the 2007 prices are significantly lower.

45. Based on the above findings, DTI sent letters to 11 flour millers asking them for clarification why ex-mill prices of flour are not reduced accordingly despite the decrease in the price of wheat in the international market, freight cost, foreign exchange rate and the imposition of zero (0) tariff. Only seven flour millers responded to the letters sent by DTI. Some of the reasons given were:

- The manufacturing costs including power cost and wage have gone up from 2007 to 2010.
- The difference in the price of flour within the span of three years (Jan-May 2007 and Jan-May 2010) reflects the price movement of wheat in the world market and covers their cost of operation.
- With the very competitive market for flour and with the industry experiencing an excess capacity, market forces will eventually continue to dictate the prevailing prices in the market.

46. Some of the millers reduced their prices but because these reductions were not within the DTI recommended price range, DTI filed separate Complaint-Affidavits against the 11 flour millers before the DTI-National Capital Region for violating Section 5(2) of the Republic Act 7581 or the Price Act defining and prohibiting profiteering as one of the illegal acts of price manipulation. *Profiteering is defined as the sale or offering for sale of any basic necessity or prime commodity at a price grossly in excess of its true worth.*

47. Preliminary Orders were sent to eleven flour millers ordering them to suspend the distribution and refrain from selling flour at the ex-mill price ranging from P770.00/bag to P790.00/bag and to reduce it to P630.00-P680.00. DTI also conducted ocular inspections at the plants of flour millers.

3. Role of the Department of Trade and Industry

48. Because of the fluctuating movement in the prices of flour in the market, the Department continuously coordinates with the flour milling industry to discuss the price and supply situation of flour. Under Republic Act 7581, the Department of Trade and Industry is mandated to come up with programs to stabilize prices and supply of basic necessities and prime commodities which includes flour.

49. Flour is included in the list of products that are monitored weekly to ensure that prices are within the reasonable prices. Prices of wheat are updated on a weekly basis to monitor the movement in the prices of wheat in the world market. Whenever the Department sees that there is a need to bring down prices of flour, millers are notified to review their prices. Holding talks with millers and appealing to them to decrease their prices are also done to limit price increases.

50. The Department is also being notified by the millers whenever there is an increase in the prices of flour. To validate the increases, millers are asked to submit their ex-mill prices and justifications for any price increase.

51. To support consumers on the increasing prices of loaf bread and pan de sal, three big bakery associations in the Philippines (Philippine Baking Industry Group, Philippine Federation of Bakers Association, Inc. and Filipino-Chinese Bakers Association, Inc.) in cooperation with the Department of Trade and Industry and in partnership with various convenience stores and supermarkets came up with a Pinoy Tasty and Pinoy Pan De Sal Project. This is to provide consumers with tasty loaf and generic pan de sal that is within the reach of the Filipino consumers.

52. Because of the high price of flour in the market, the Department intensified its monitoring on the movement of prices of wheat in the world market and locally milled flour. DTI is looking on the possibility of setting a Suggested Retail Price (SRP) if price of flour remains to be high despite the decrease in the price of wheat in the world market.