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SERIAL OFFENDERS: WHY SOME INDUSTRIES SEEM PRONE TO ENDEMIC COLLUSION

Contribution from Philippines

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SERIAL OFFENDERS: SECTORS PRONE TO ENDEMIC COLLUSION

-- Philippines¹--

1. Competition policy aims to maintain and sustain competition rules and procedures that enable rivalry among market players to produce outcomes that are beneficial to consumers. Tampering with these regulations adversely affects the competitive process that consequently leads to market distortions and inefficiencies.

2. One such distortion is collusion among market participants that strengthen their monopolistic, oligopolistic or monopsony powers to the detriment of consumer welfare.

3. The Department of Justice (DOJ)-Office for Competition (OFC), legislatively chartered to investigate and prosecute all criminal offenses arising under the Philippine Competition Act² and other competition-related laws, has conducted several investigations looking into the cartelization of the commodities sector in the Philippines.

4. This country presentation aims to share the experiences of the OFC in these investigations with the objective of contributing and enriching the discussions on sectors that are prone to endemic collusion. This paper will also examine the factors as to why the commodities sector in the Philippines is prone to hardcore collusion and will discuss implications in terms of enforcement tools and prioritization.

1. Facilitating factors for collusion

5. Hardcore cartels such as price-fixing, bid-rigging, market sharing and output restriction result when the competitive process is tampered with—such as when competitors agree to fix price, rig bids, limit and control, or divide and share out the market with the objective or effect of substantially preventing, restricting, or lessening competition.

6. Economic theory suggests that the two most important aspects where cartelists take a concerted action is their agreement on prices and/or allocation of markets.³ Substantiating this theory are economic analyses which discuss the factors that facilitate cartels. These are summed as follows:⁴

¹ Geronimo L. Sy is Assistant Secretary at the Philippine Department of Justice and Head of the DOJ Office for Competition.

² Section 13 of the Philippine Competition Act or Republic Act 10667 states that the OFC under the Department of Justice (DOJ-OFC) shall conduct preliminary investigation and undertake prosecution of all criminal offenses arising under this Act and other competition-related laws...

³ Hyytinen, A., Steen, F. and O. Toivanen. Anatomy of cartel contracts. CEPR Discussion Paper: 2013. Also available at: [https://feb.kuleuven.be/public/n10076/Hyytinen Steen Toivanen 2015_01_16.pdf](https://feb.kuleuven.be/public/n10076/Hyytinen_Steen_Toivanen_2015_01_16.pdf)

⁴ Reference to Price Fixing, Bid Rigging, and Market Allocation Schemes: What They Are and What to Look For. An Anti-Trust Primer. Also available at: <http://www.justice.gov/sites/default/files/atr/legacy/2007/10/24/211578.pdf>

a) Industry conditions and market structure

Collusion is likely to occur when there are few sellers because this facilitates agreement on prices, bids, customers, or geographic markets. However, this does not preclude the ability of large number of firms to collude if the market is characterized by a small group of major sellers and the rest are "fringe" or peripheral sellers who control only a fraction of the market.

b) Substitutability of product/commodity

The prospect for collusion increases if products are easily substituted for another or if there are restrictive specifications for the procurement of the product.

c) Product standardization

Related to product substitutability, product standardization makes it easier for competing firms to reach an agreement on a common price structure. Conversely, it is more difficult to agree on a product with a variety of design, features, quality, or service.

d) Institutionalized networks and contacts

Collusion is likely to occur if competitors know each other through social networks, trade organizations, legitimate business dealings, or employment transfers. In the case of bid-rigging, bidders who have an opportunity to communicate or contact each other may increase the chances of collusion; contractors who have become familiar with bidders may also provide opportunities for anti-competitive agreements.

e) Legal and policy regulatory environment

Regulatory mechanisms in form of rules and policies may sometimes facilitate collusion through bureaucratic layers that enable partiality and subjectivity which can be abused.

2. Collusion in the Commodities Sector

7. In September 2014, the OFC released the results of its investigation on alleged garlic cartelization in the Philippines. The investigation was based on a presidential directive for the OFC to look into the unconscionable prices of garlic which increased to almost 300 percent from average prices.

8. In its report, the OFC found that there was adequate supply of garlic but was unduly restricted by four (4) entities which controlled the industry. This was done by cornering the import permits that were ostensibly for the purpose of checking the quality of imported garlic.

9. In January 2015, the OFC conducted another investigation within the commodities sector, specifically the onion industry. The OFC Report revealed that the same personalities, using similar *modus operandi* to corner the import permits of the relevant agency, manipulated onion supply and affected its prices.

10. Previous OFC investigations include alleged bid-rigging case for rice import allocations by farmers' operatives/organizations (FOs) and sole proprietorships which were mere dummies of at least two (2) groups of rice traders/importers. Another case involved alleged price-fixing among incorporators,

major shareholders, corporate officers, and operators dealing with liquefied petroleum gas (LPG). This case is currently with the trial court.

11. The said goods subject of OFC investigations are either considered basic necessities or prime commodities. Basic necessities such as rice and LPG are goods vital to the needs of consumers for their sustenance and existence. Meanwhile, prime commodities such as garlic and onion are goods not considered as basic necessities but are essential to consumers.

12. The OFC experiences in cartel investigations reveal the susceptibility of the commodities sector to collusion. Several factors as deduced in the investigation reports may account for this:

- i) The use of government mechanisms, *i.e.*, permit system to engage in unlawful combinations and control the importation of goods;
- ii) Lack of clear and transparent regulatory environment that facilitates the creation of dummies and dummy organizations;
- iii) Bureaucratic layers that provide opportunities for collusion and shroud detection;
- iv) Agency rules and procedures that are fraught with subjectivity and give unbridled discretion to agency head/regulator.
- v) Entrenchment of small group of players in the market as a result of crony politics/crony capitalism.

13. These factors lead us to the question of what motivates individuals to collude in the commodities sector. A framework of analysis is laid by Siegfried Tschierschky who “differentiated firms’ desire to form cartels (*motivation*), industry conditions (*structure*), from their capacity to do so (*competence*).”⁵ He stressed the “psychological willingness,” or the “ethnological” and “personal moment” among cartelists where cartel sustainability depended on the ability of these cartelist firms to regard customers, not disregard them, and their ability to lower prices at times to secure higher, long-run profitability.⁶

14. In the Philippine context, the unique attributes of the commodities sector facilitate cartelization: inadequate local supply due to seasonal variations and natural calamities, import dependency, and a complex supply chain in between which is prone to manipulation by scrupulous players.

15. As in the garlic case, the two marketing supply chains for garlic in the Philippines—importers and local growers or producers—provide possible bottlenecks or areas where hoarding may be successfully carried out or where collusion may easily take place.

16. The seasonal characteristic of commodities can also be used by cartelists to justify price fluctuations. For example, onions in the Philippines are one-season crops grown from October to February.⁷ Augmentation of local supply during off-peak season where the Philippines imports onions rationalizes the use of import permits that are prone to abuse by cartelists. Individuals and firms can also use as an excuse the low supply of commodities during off-peak season to jack up prices and utilize the principle of demand and supply to defend price increases.

⁵ Fear, J. Working Paper on Cartels and Competition: Neither Markets nor Hierarchies. 2006. Also available at <http://www.hbs.edu/faculty/Publication%20Files/07-011.pdf>

⁶ Ibid.

⁷ Report on the Onion Industry. DOJ-Office for Competition. Manila:2015.

17. Existing regulatory environments for contacts and networks can also expedite collusion. The “open and relational” trait of Filipinos may enable networks and small groups to have avenues for collusion.

18. For instance, the government procurement law in the Philippines allow for the conduct of “at least one pre-bid conference shall be conducted for each procurement.”⁸ The implementing rules and regulations of this law also state that “the requirement for face to face bidding conference may be replaced once videoconferencing, webcasting, or similar technology becomes the norm in business transactions in the country...procuring entities with videoconferencing capabilities that have manufacturers, suppliers, distributors, contractors and/or consultants that also have videoconferencing capabilities may conduct their pre-bidding conferences electronically.”⁹

19. This case shows that legal mechanisms can sometimes facilitate collusion among bidders and may even inadvertently provide methods on carrying out such acts.

3. Way forward: Implications for enforcement

20. Technological advancement have indeed paved the way for easier detection of collusive agreements via more open and transparent information-sharing techniques as well as exchanges of enforcement tools and constant building up of technical competence. While several studies on economic theory have developed guidelines on factors that are considered conducive to collusion and can therefore shed light on the issue, it is also important to consider the varying contexts and circumstances of the country where anti-competitive conduct occurs.

21. The Philippine experience for instance shows that beyond economic theories, an explanation on endemic collusion may lead one to examine issues of governance and political culture. As discussed, the relational attribute of Filipinos, the unique characteristics of the sector in question, and the regulatory and policy environments all converge to explain endemic collusion.

22. As the OFC continues to evolve in the realm of the Philippine competition enforcement agenda, it seeks to undertake the following next steps:

- i) Set up an enforcement procedure that highlights the investigative powers of OFC vis-à-vis the rights of the investigated parties and other interested third parties;
- ii) Continue upgrading its technical competence particularly in the review of best practices covering surprise inspections, information requests, searches and seizures, rules on confidentiality/business secrets, right of parties to intervene, confidentiality rules, and settlement procedures;
- iii) Enhance utilization of evidence detection in cartel cases and use of IT forensic toolkits;
- iv) Establish protocols of cooperation with other competition authorities to address the international dimension of some cartels; and
- v) Maximize the benefits of bilateral relations through confidence-building mechanisms in cartel enforcement.

⁸ Republic Act 9184 or Government Procurement Reform Act of the Philippines.

⁹ Revised Implementing Rules and Regulations of RA 9184. Also accessible at: <http://www.gppb.gov.ph/laws/laws/RevisedIRR.RA9184.pdf>