

Why cement prices remain high despite zero tariffs

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Looking at the different economic characteristics of cement firms, this Note argues that the firms can collectively exert market power. This has resulted in weak competition to the detriment of consumers, particularly small users. Hence, even with the government's recent zero tariff policy on cement imports, cement prices have gone up unabatedly. Without an effective competition law, the country has very little recourse against industry collusion and cartel.

The backdrop

Early this year, Senator Francis Escudero urged the Department of Trade and Industry (DTI) to explain why cement prices surged to P270 per bag, which is double the price of two years ago (Senate of the Philippines 2010). Consumers have complained that despite the economic slowdown due to the recent global financial crisis, cement prices did not drop.

This is in contrast to the report (Osorio 2010) that prices of other construction materials like steel fell by 30–60 percent in 2008 while prices of production inputs like crude fuel dropped from US\$140 to \$40 per barrel and coal from US\$200 to below \$100.

In response, the Cement Manufacturers Association of the Philippines (CEMAP) announced last month that price increases are necessary despite sluggish demand because manufacturers are seeking to recover high production costs (Ho 2010). Republic, the local associate of La Farge, also announced that it implemented a price hike of P8 per bag in May because of increased operating costs (De Vera 2010a). Holcim, meanwhile, earlier warned of higher prices in the second

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quarter due to the power shortage in Mindanao (De Vera 2010b).

History of perennial price increases

In the past ten years, rising cement prices have always been an issue in the country. Both the DTI and the House of Representatives conducted investigations in the early 2000s to look into a possible collusion among members of the alleged cartel. Given the perennial price increases amid excess supply and weak demand during this period, many analysts suspected that a cartel was at work. The industry association, then known as Philippine Cement Manufacturers Corporation (Philcemcor), countered that the price increases were inevitable due to the firms' high production costs and finance charges (Aldaba 2002).

Figure 1 shows the behavior of the average monthly price per cement bag from January 1993 until December 2009. Cement prices increased steadily during the following periods: 1993 to early 1997, January 1999 to December

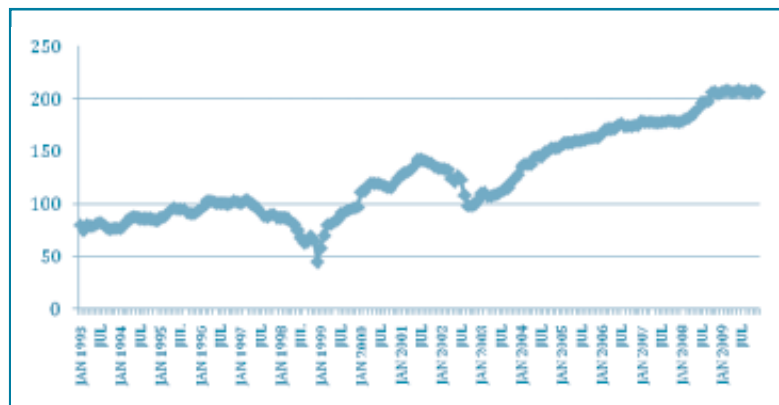
2001, and from December 2002 onwards. Note that coinciding with the 1997 Asian financial crisis, mergers and acquisitions within the industry took place from 1997 to 1998. A continuous drop in cement prices was observed during these years. A safeguard duty of P20.60 per bag on cement imports was also temporarily imposed from November 2001 until the end of 2004. During this time, cement manufacturers agreed with the DTI not to raise prices. Yet, while cement prices briefly declined until November 2002, they started to increase unabatedly thereafter.

With mounting calls from various sectors to bring down cement prices, the government temporarily removed tariffs on cement for six months through Executive Order (EO) 766 issued in November 2008. After said EO expired in June 2009, EO 819 extended it for another six months. Prices, however, still remained high. In mid-December 2009, prices in Metro Manila and nearby provinces went up to as high as P260 per bag, from P205 per bag in early December, due to an artificial shortage created as the big three cement companies Cemex, La Farge, and Holcim decided to simultaneously shut down their plants in Antipolo and Bulacan for annual maintenance activities.

The alleged cartel issue: sources of market power and why zero tariffs do not translate into lower prices

Like other *homogeneous goods* such as sugar and flour, cement is often

Figure 1. Cement average monthly prices



Source of basic prices: Department of Trade and Industry, Philcemcor, and NEDA for earlier years in the 1990s.

characterized as a market that is prone to collusion. Moreover, cement is a type of high weight-to-value product with *high transport and handling costs*. Hence, it is often classified as a nontraded good. While potential competition from imports is important as a mechanism to control market power and ensure competition, this is of little practical value because of the substantial costs of import entry. Cement can be imported in bulk, but this will entail a bulk handling facility that would require a substantial amount of investment. On the other hand, shipping cement in bags will entail extra handling costs that could easily translate to increases in price. These factors limit the procompetitive effects of imports on the industry and provide a natural protection against imports.

Note, however, that substantial imports penetrated the country in 2000 at 5 percent tariff as a result of the global excess supply and low prices arising from the Asian financial crisis and in response to the relatively high domestic prices prevailing in the country.

It seems, however, that traders do find the business of importing cement too risky and costly. For instance, based on an interview conducted by Isip (2009), the cost of imported cement, including transport and port integration charges, is about P178 per bag. The ex-factory price of locally manufactured cement, on the other hand, is P185 per bag and with mark-up and transport cost of P10 per bag, the retail price is around P205 per

bag. Despite this, though, traders consider the price difference between landed cost and ex-factory price as insufficient to cover the huge risks involved in the cement import business.

Even at zero tariffs, traders still consider cement importation a high risk business. According to them, it is not viable due to high logistic costs and to the fact that local cement manufacturers have the market power to easily match or underprice imported cement. In the same interview by Isip (2009), she noted that traders are aware that local manufacturers can easily bring down their prices in areas where any shipments come in. Moreover, they know that imported cement can only compete with a small segment of the market composed of small users since local manufacturers have long-term contracts with big customers and contractors wherein they (local manufacturers) provide special discounts for bulk sales.

Cement imports have thus been historically small. Table 1 shows that there were, in fact, only two years when imports as a percentage of total domestic supply exceeded 10 percent. These were in 2000 (13%) and 2001 (19%).

Traders pointed out that the only way for zero tariffs to have an impact on prices is through owner-supplied importation in areas where port integration charges are cheaper. But doubts abound on whether DTI's plan of bringing in cement through the Philippine International Trading Corporation would be a feasible

Table 1. Industry statistics (in million 40-kg bags)

Year	Production	Total Sales	Domestic Supply	Imports	Exports	Import Ratio	Export Intensity
1998	515.52	512.00	515.76	7.25	3.43	1.41	0.67
1999	502.28	502.40	493.76	18.98	27.65	3.84	5.51
2000	478.36	472.84	482.28	63.16	57.32	13.10	11.98
2001	455.12	453.80	468.56	89.33	74.56	19.06	16.38
2002	535.88	531.92	504.04	13.50	41.39	2.68	7.72
2003	522.68	523.60	484.80	0.39	39.22	0.08	7.50
2004	522.28	519.64	487.36	0.51	32.78	0.10	6.28
2005	494.72	501.28	463.40	4.65	42.16	1.00	8.52
2006	481.32	487.80	468.56	9.75	28.98	2.08	6.02
2007	521.92	522.64	520.44	12.08	14.26	2.32	2.73
2008	534.76	524.16	528.68	4.53	21.93	0.86	4.10

Note: Total sales cover domestic sales and exports. Domestic supply is production less exports.

solution. Is the government ready to pay the high cost of another price stabilization scheme?

The Philippines' recent experience shows that even with the removal of tariffs, competition in the industry has remained weak. In the early 1990s, for instance, cement prices were deregulated, import restrictions were lifted while tariffs were set at a low rate of 5 percent. Yet, the high and rising trend of cement prices seems to indicate that previous trade liberalization and even the more recent tariff elimination are not enough to ensure that markets would perform efficiently. The industry has remained highly concentrated, with three firms controlling almost 90 percent of the market. Entry barriers are also high because of the *large capital requirements* needed to operate

¹ The price elasticity of demand measures the responsiveness of demand to changes in price. If demand is inelastic (value less than one), a price increase will increase total revenues while if demand is elastic (greater than one), a price increase will decrease revenues (Khemani and Shapiro 1993).

a cement plant. Moreover, *demand for cement is inelastic*¹ which provides another important source of power to firms to control prices.

All these characteristics tend to indicate that cement firms can collectively exert market power and their price behavior seems to show that they are indeed able to exercise it. As such, competition has been limited and has negatively affected consumers, particularly small users. The history of coordination in the industry bolsters the presumption that individual firms are not acting on their own and are consciously engaged in implicit coordination.

This can be seen in Figure 2 which shows the pricing behavior of the industry, using changes in monthly cement prices (expressed in constant terms with 1985=100) from January 1993 to December 2010. Cement prices are seasonal; they rise during summer and fall during the rainy months. Notice the near uniformity and symmetric price movements throughout the 16-year period illustrated in the figure. The threat of a price war and fear that departure from such behavior may lead to costly price cutting, lower profit margins, and market instability have prevented firms from engaging in competition. As Philip Roseburg of La Farge Philippines described their behavior (Ferriols 2001):

In any industry, you can fight for a bigger market share but someone has to

give up that market share... But obviously this wouldn't work with our competitors here...they will fight and then we get into a bloody battle where everyone ends up bruised. Given the opportunity, yes, we can try and improve our market share. But I don't want to lose out in the end and trigger another price war... LaFarge has no plans of rocking the boat. We wouldn't make a run on market share, we want to keep it as stable as possible.

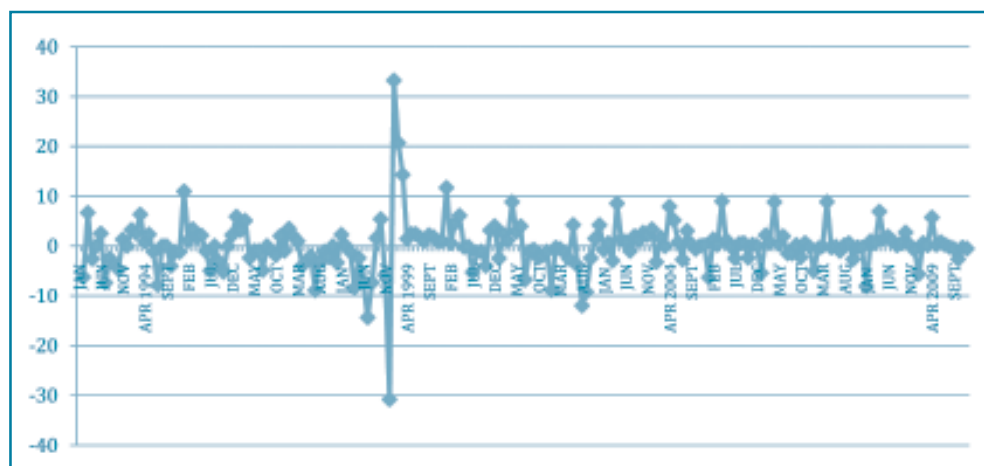
In general, monthly price movements have ranged between -10 and +10 percent except for a few outlier years in 1998, 1999, and 2000. Figure 2 indicates that for the years 1993 and 1994, the highest price changes of around 6–7 percent took place during the month of March. From 1995 to 2000, price changes peaked during the month of January registering 11 percent in 1995, 6 percent in 1996, 2–3 percent in 1997–1998, and 33 percent in 1999. The latter were merger and crisis years when prices were declining. From 2001 to 2009, the largest price changes were registered in April. These ranged from 6 to 9 percent except in 2002 when cement firms promised DTI that they would not increase their prices in exchange for the additional duty imposed on cement imports.

Implication for policy: need for competition law

In countries with strong competition laws, cartels are illegal and are treated toughly. In the Philippines, though, in the absence of a clear, comprehensive, and enforceable competition law, the task of prosecuting cartels has been difficult. Since the DTI does not directly deal with cartels as a competition issue, it could not penalize anticompetitive behavior.

Since the early 1980s, there have been various attempts to legislate new competition laws. However, most of these have remained pending, indicating the lack of appreciation and political will to legislate a comprehensive competition law for the country. During the 11th Congress, there were two House bills that proposed the creation of a fair trade commission. In the Senate, two bills sponsored by Senators Sergio Osmena III and Juan Ponce Enrile were presented. In the 13th

Figure 2. Monthly percentage change in cement prices (1985=100)



Note: Current prices were deflated using construction deflator from the National Income Accounts.

Congress, there were three competition bills filed by Senators Osmena III, Manuel Villar, and Enrile. In the recent 14th Congress, the bill of Senator Enrile was able to move and got approved by the Committee. However, the process has since been stalled at the House of Representatives.²

Conclusion

The outcome of cartel behavior is against public interest and is highly distortive of economic efficiency. Cartels limit competition and allow firms to manipulate prices to the detriment of consumers and other industry users, including the government. The experience of the cement industry illustrates that trade liberalization does not automatically lead to competition in the domestic market. Given the characteristics of the industry, incentives are present for firms to engage in anticompetitive practices. Thus, removing import restrictions and eliminating tariffs are not enough to ensure competition. One important lesson is the need to accompany trade reforms with measures to increase competition. Without an effective enforcement of competition law, the country has very little recourse against cartels and collusion. 📄

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² The Enrile bill aimed to penalize combinations or conspiracies in the restraint of trade and all forms of artificial machinations that will destroy, injure, or prevent free market competition. In the House, the Cua bill proposed the creation of a Philippine Fair Trade Commission to investigate, gather evidence, and initiate prosecution of those engaged in unfair trade practices.