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COMPETITION POLICY AND THE INFORMAL ECONOMY

Contribution from Chinese Taipei

-- Session II --

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COMPETITION POLICY AND THE INFORMAL ECONOMY

--Chinese Taipei--

1. Introduction

1. According to Article 2 of the Fair Trade Law of Chinese Taipei (hereinafter the “Law”), the Law is applied to a company, a sole proprietorship or partnership, a trade association, and any other person or organisation engaging in transactions through the provision of goods or services. Therefore, almost all kinds of undertakings, regardless of whether they are natural persons, small-sized stores and vendors, different types of companies, or trade associations carrying out formal or informal economic activities will be under the jurisdiction of competition enforcement.

2. However, defining the informal economy and identifying data sources are difficult tasks because of varying degrees of non-compliance. The Directorate General of Budget, Accounting and Statistics (hereinafter the “DGBAS”), a Cabinet-level office, which handles most of the duties of the national statistical reports used as reference for policy-making, has estimated the underground economic activities in 1992 and 1999, respectively. In the past research conducted by the DGBAS, all kinds of informal trading activities have referred to paid informal work. Paid informal work is composed of the following types of economic activities:

- illegal and unregistered activities, such as smuggling, unlawful lumbering, collecting river stones and sand without government approval;
- evasion of direct and indirect taxes from earnings, by mainly focusing on the work performed by the professions, such as those comprising lawyers, accountants, physicians, pharmacists, architects and performers;
- avoidance of taxes and regulations where the focus is on the production and sale of goods and services that are unregistered, or hidden from government regulations, such as goods and services supplied by street vendors, unregistered factories, loan clubs, tutors, nannies, and Japanese Pachinko parlours.

3. Different measures used to assess the ratio of the informal economic activities contributing to GNP give rise to different results. In spite of the lack of current official statistical data, in the 1990s, according to local academic research, the value of informal economic activities accounted for a share of some 20% to 30% of GNP. The ratio was even estimated as being as high as 47% in 1997 due to the hidden trade across the Taiwan Strait. Consequently, the figure of GNP was partly distorted. Some economists alleged that if the informal activities had been included in the national payments system, the value of GNP would have been higher. However, others have argued that considering that informal and formal players compete against each other in every sector in the economy, informality removes the incentive for businesses to improve their productivity, which means that it holds back GNP growth accordingly.

4. From the consumer’s point of view, the supply of goods and services by the informal sector provides added variety, offers more competitive prices and brings convenience. Before the deregulation was implemented, including the opening of direct air and sea routes across the Strait, the opening of banks to China, and the loosening of restrictions on the number of Chinese tourists, Chinese Taipei shipped about 20% and 15% of its exports to China and Hong Kong, respectively, and most of the Hong Kong-bound exports were then transported to China. This illustrates that the cross-Strait economic activities were characterised by gray economic activities due to the strict regulations.

5. The existence of night markets in Chinese Taipei is another example that demonstrates that informality provides variety. A night market clustered with large numbers of street vendors providing assorted snacks, souvenirs and entertainment services is a combination of traditional culture and modern consumption, and has also gradually become a tourist attraction. On the other hand, luxury boutiques, department stores, and supermarkets may be many times as attractive as their informal rivals, and they may also offer higher quality. After all, the market variety provides consumers with opportunities to freely interact with both formal and informal businesses.

2. Examples of Fair Trade Commission Practices

Case I

6. A case currently under discussion, can demonstrate how government regulations that curb the informality affect the provision of services. The Children's Bureau under the Ministry of Interior (hereinafter the "CBI") is the competent agency responsible for child welfare services. To achieve its policy goal, the CBI has a vision to establish a community nanny-support system, to reinforce the training of nanny, and to build a professional image with nanny certification so as to upgrade the quality of nurseries.

7. The CBI has planned to implement a subsidisation project to improve professional babysitter practices and promote community nanny-support systems. According to its draft plan, every household sending a child to a nanny with both CBI certification and membership of the community nanny-support system will be able to apply to the local government for a subsidy of NTD3,000 per month (approximately US\$100). Furthermore, in order to prevent nannies eligible for subsidies to collude accordingly on increasing pro rata their service charges, the CBI recommended that local governments set a maximum cap for the nanny services to ensure that the system will not be circumvented. Due to concerns that the price-cap recommendation may run against the Law, the CBI sent a letter to solicit the opinions of the Fair Trade Commission of Chinese Taipei (hereinafter the "Commission").

8. In the past, households could acquire child-care services by hiring experienced unlicensed nannies, college students or day-care centres, or by having free services provided by family members, such as grandparents. Although the number of babysitters with official certification has increased from 7,302 in 1998 to 37,610 since the CBI was established in 1999 and there are 41 community nanny-support systems organised by 23 local governments, nannies from the formal sector can not meet the demands of parents since the average number of children under the age of 6 is more than 300,000. The huge gap between demand and supply make the task of assessing the scale of the informal economy in the nanny service sector too difficult to develop a pro-competition policy.

9. Although the Women's Rights Council of the CBI insisted that formulating the maximum standard for the service charge was the only way parents could prevent nannies from exploiting the provision of the government cash subsidy for their own advantages and ensure the quality of the child-care services, the Commission advocated that the CBI implement other optional policies to achieve the same policy goals. The Commission tried to persuade the CBI to accept that the best way to ease the upward pressure on the price was to increase the provision of nanny services instead of setting the price cap. The Commission further suggested that the CBI avoid unnecessary or disproportionate restrictions on the provision of nanny services to avoid unexpected price rises due to collusion. This case is still under consultation by different government agencies.

Case II

10. The second case is concerned with how the government streamlines taxes and regulations to tackle the problems created by the informal sector. With the island of Taiwan located in the middle of a chain of islands stretching from Japan in the north to the Philippines in the south, and only 160 kilometres off the south eastern coast of the Chinese mainland, the fishery industry is one of the most important primary industries of Chinese Taipei due to its superior geographical location. Owing to the painstaking devotion of researchers as well as the diligence of the fishing entrepreneurs, Chinese Taipei's fishery industry has rapidly developed and has gained worldwide recognition. In recent years, its overall production has exceeded 1.3 million tons, with a total value of nearly NT\$100 billion. Over 130,000 households, or approximately 340,000 people, are engaged in the work of the industry.

11. The Council of Agriculture (hereinafter the "COA") is the highest fishery policymaking body in Chinese Taipei, under which the Fishery Administration (hereinafter the "FA"), is established to be the highest fishery administrative agency. Fishermen's associations formed by fishermen operate for such purposes as safeguarding fishermen's rights and interests, enhancing fishermen's knowledge and skills, boosting the modernisation of the fishery industry, increasing fishing production, and improving the fishermen's livelihood. The FA has authorised the state as well as 39 local fishermen's associations to handle affairs regarding awards, aid and subsidies to encourage the industry.

12. In recognising that fuel costs account for as much as half the earnings from the boats themselves and cannot be passed on, the Chinese Taipei government has continued delivering funding support in relation to the fishing boats' fuel consumption since 1958. The CPC, which is a state-owned monopoly with overwhelming power in both the wholesale and retail petroleum markets, has offered preferential rates in respect of fishing fuel prices for any type of vessel registered in Chinese Taipei for the purposes of fishery operations. The CPC has submitted the applications for such subsidies to the FA to compensate for the difference between the wholesale price and the preferential price of the fuel.

13. In addition, according to Article 59 of the 1991 amendment to the Fisheries Act and Article 8 of the Value-added and Non-value-added Business Tax Act, fuel for powered equipment used in the fishery industry shall be exempted from commodity tax (approximately NT\$3.8 per liter for diesel fuel, and NT\$6.5 per liter for gasoline in 2000) and business tax. The 1991 amendment to the Fisheries Act further strengthens the regulation on subsidising fishing fuel consumption in order to maintain the fairness of the market, and such an amendment has required the Cabinet to set the operating standard for fishing fuel purchased at preferential prices. In practice, the FA has been continuously providing a 14% subsidy based on the wholesale price excluding taxes.

14. Since the petrochemical components of the fuel used for the purpose of powering the fishing boats are almost identical to those for diesel, the amount of the exemption together with the government subsidy have been giving fishermen financial inducements to sell the fuel to local gasoline stations so as to earn additional profits to that from fishing income. In particular with the fishing industry having been hard hit with the progressive increases in petroleum prices, the FA has made many efforts to raise the subsidy over the period from 2002 to 2007 in order to help the fishing industry adapt to the high fuel costs.

15. When global oil and commodity prices remained at high levels, domestic trading firms and unregistered oil firms that fully or partially evaded taxes, and product, labour, land and security regulations, took advantage of the special features of the diesel market. As the government has been continuously providing a 14% fishing fuel price subsidy to revitalise a sluggish fishing industry caused by a depletion of fishing resources, the excess fishing fuel, which is estimated to amount to 410,000 kiloliters a year, has been sold as diesel in domestic gasoline stations or informal oil firms for higher profits. These practices have not only directly affected the tax revenues of the government and wasted the government's

funding support, but they have also significantly affected the competition in the formal sector. The use of inferior gasoline or diesel will damage the engines of vehicles as well as increase the level of air pollution. In addition, as such practices are usually carried out using makeshift facilities such as storage tanks, they have posed a great threat to security and the environment. In order to prevent underground trading from undermining the well-intentioned subsidy to fisherman from the government subsidy, the FA gradually requested that fishermen equip fishing vessels with mileage tracking facilities so as to assess the real fuel consumption amount and prevent non-users from avoiding fuel taxes.

16. Unlikely the fishery administrative agency, the Commission has been more concerned with the inappropriate government regulations in the market. The petroleum and its related upstream and downstream product industries were highly regulated by the Ministry of Economic Affairs (“MOEA”) until the ban on privately-owned gasoline stations was lifted in 1987 as the very first stage of deregulation. Subsequently, in June 1996 the market was opened up to applications for the establishment of new petroleum refineries and at that time the privately-owned petroleum refining company Formosa Petrochemical Corporation (“FPCC”) was authorised to enter the market. After the promulgation of the Petroleum Management Law in October 2001, by removing the restrictions on the establishment of a petroleum refinery with a minimum capacity, the petroleum gasoline, diesel, fuel and related products market was free to be entered by any potential competitors.

17. However, the FPCC faced challenges as it sought to take part in the fishing fuel market. The FPCC in its report to the Commission pointed out that the FA had adopted a subsidy application procedure that differed from those used for fuel purchases from the CPC in 2003. The CPC filed the subsidy application form directly with the FA for its approval, while the FPCC was required to submit subsidy applications to the local government for purposes of government auditing so as to send the case to the FA for a final decision.

18. In the eyes of fishermen, buying fishing fuel from CPC-owned, CPC-franchised or private-owned petrol stations, or else fishermen’s associations with fuel storage facilities are all good substitutes for each other. However, the said subsidy application procedure is likely to have made retailers reluctant to source their fuel from the FPCC since the period for collecting the preferential price compensation due to the government subsidy has been constantly delayed by the lengthy review process.

19. The FA asserted that according to Article 17(1) of the Regulations Governing the Allocation of Bunker Fuels: “Fishermen’s associations acting as bunker fuel purchasing agents shall submit a detailed table of the previous month’s bunker fuel purchases and deliveries, and the circumstances of those transactions, to the relevant county (city) or special municipality and central government competent authority for fisheries by the fifth day of the following month.” Consequently, the FA has been able to require local governments to review the subsidy applications prior to its approval and the Fair Trade Law has not been applicable in such cases. Moreover, given that the CPC is a state enterprise supervised by the Commission of National Corporations under the MOEA and its budget allocations are subject to government budget auditing regulations, and the CPC has also been the sole fishing fuel wholesaler and retailer in the ports, to save on administrative costs, the FA ignored the review procedures of the local governments in regard to CPC subsidy applications in the past.

20. However, given the discrepancy in procedures for applying for fishing fuel subsidies, new entrants, who cannot offer as fair, or better, trading terms to compete with or substitute for the terms of the incumbent, will hardly survive. The Commission advocated that the FA take its suggestions into consideration in carrying out its fishing fuel subsidy processing operations in the interests of promoting fair competition in the domestic fishing fuel market so as to allow the new suppliers to enter the market when the domestic petroleum market was fully liberalised at the end of 2001.

21. On the one hand, the Commission has made efforts to streamline regulations to promote competition in the market with the informal sector; on the other hand, it has remained neutral on the issue of criminality in relation to informal activities. The following case will point out those criminal activities where the goods and services themselves are illegal.

22. When the volume of imported supply and domestic production as well as the domestic consumption and inventory according to the disclosure of Customs' data are compared, it is found that an annual total of approximately 400,000 kiloliters of various imported oil products were blended into gasoline or diesel to be sold in 2003.

23. As it is difficult to detect and thereby root out the underground transactions of such inferior gasoline and diesel fuel, the police with insufficient legal tools can only passively inspect suspected inferior supplies. This has resulted in illegal transactions of unqualified gasoline and related products facing little curtailment.

24. Although both the CPC and the FPCC have complained that the weak governance structures contributing to such an informal economy will distort market order, the quality of the products sold through legal channels is not necessarily always good. In 2007, a worker at a gas station sourcing gasoline and diesel from the CPC admitted that she took orders from her boss to mix the gasoline with methyl alcohol. The workers' confession prompted prosecutors and investigators to hunt for the owner of the gas station. Consequently, five executives of the state-run CPC, including its president and the CEO, were penalised with demerits for lax supervision of the operations of the gas station that had been selling oil products supplied by the CPC for many years. The MOEA announced the punishments for officials at its Energy Bureau, which is responsible for national energy policies. Unconfirmed reports show that the gas station owner purchased a shipment of 50,000 liters of methyl alcohol and mixed the chemical product with 500,000 liters of unleaded gasoline. This shipment alone could have filled up oil tanks and affected at least 30,000 vehicles. However, the Commission has seldom gotten involved in these issues. It seems clear that the Commission considered that the informal work covers only activities where the means do not comply with regulations but the end goods and services are legitimate.

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