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## **Global Forum on Competition**

### **COMPETITION POLICY AND THE INFORMAL ECONOMY**

#### **Contribution from Peru**

-- Session II --

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## COMPETITION POLICY AND THE INFORMAL ECONOMY

--Peru<sup>1</sup>--

### 1. Introduction

The Political Constitution of Peru (1993) rules that the State promote and guarantees to firms and consumers their participation in the market governed by the principle of free competition and free private initiative.

Under an economy of social market model, the role of the State is not reduced, but oriented to supervise and promote the investment, taking part only in the provision of goods and services when the private sector is not able to supply them and or to match the demand of basic needs (health services, education, basic infrastructure, and the likes).

The constitutional frame guarantees the free competition and protects consumers, and it allows design policies and practices as instruments to reach these economic and social objectives.

In effect, academics argue that in a competitive market, the consumers will benefit from low-price goods and services, better quality and product diversity. The competitive process allows consumers to choose the product according to their needs and budget restriction.

On the other hand, the companies may obtain benefits because the market forces them to be more efficient. In competition, the companies will reduce their total costs of production (productive efficiency), increase the quality and diversity of their products or services and provide to the consumers products with prices near their costs. As a result, competitiveness of the companies will increase with the possibility of successfully taking advantage of a process of economic integration (e.g. Free Trade Agreement).

Finally, the government will also be benefited. The competition will expand the national product because of the increase in tax collection, or the availability of more budget resources. This will make possible for the government to be in better position to finance the provision of public goods and services, allowing citizens to access to these ones and improving their living conditions.

Theoretically, in order that an economy may work close to a competitive market and, therefore, obtain more efficient results, the following conditions are necessary:

- (i) the existence of many suppliers in such a way that can not influence negatively in some commercial conditions;
- (ii) goods are the most homogenous possible;
- (iii) consumers have enough information so that they can make their better consumption election; and
- (iv) there are few trade barriers in the market.

Nevertheless, markets are imperfect, on the contrary, they have failures (i.e. natural information asymmetries, monopolies, anticompetitive behavior, high entrance barriers, product heterogeneous), which prevent that market agents reach their objectives with efficiency. For these reasons, the state may intervene establishing and executing policies that allow obtaining efficient results in a competitive market.

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<sup>1</sup> Juan A. Candela Gómez de la Torre, Presidente de la Sala 1 del Tribunal de Defensa, de la Competencia y Propiedad Intelectual (INDECOPI), Lima, 16 February 2009

In addition, competition and practice policies have as objective to contribute with markets in which competition is possible and desirable, assigning economic resources for the benefit of consumers, companies and the government. It also generates social efficiency.

In Peru, at the beginning of the 90s, the government created a legal framework to protect and promote the market competition, and to protect consumers and intellectual rights<sup>2</sup>. The leading institution INDECOPI appears as an administrative agency within a national system. Its role is to arbitrate and promote the market development, applying competition policies with the objective of correcting some of the failures that can be observed in the market working against the normal development of the competitive process. Thus, for example:

- It applies the free competition regulation to prevent the anticompetitive behaviour that produces an artificial deviation of the competition market, by the arbitrary agents who abuse of their position of dominion.
- The information asymmetries that increase the costs of transaction in the consumption relations, which fought by the Commission of Consumer Protection
- The Commission of Bureaucratic Barriers Elimination fights the trade barriers imposed by the State through acts or normative devices that constitute an irrational or illegal barrier to access to the market.
- The lack of products and services homogeneity is object of the Control and Standardisation Commission of no Tariff Commercial Barriers.

As it is mentioned previously, we will analyse how the informal economy existence affects the application of Competition Policies by the Competition Authority.

## **2. What is the Informal Economy?**

It is true that there is not an exact definition or concept to define and conceptualise the phenomenon. Usually, the concept use depends of the aim and scope of the study.

The modern and accepted definition is that the informal economy is part of everybody's daily life. In fact, it is a reality of the world, exists everywhere and gets larger everyday. It exists in less development countries as development ones.

The economic development theory tries to explain the causes of underdevelopment by using the dual analysis of the economy. For instance, rural and urban sectors have also been divided into formal and informal sectors. This designation was not intent to contribute to an academic proliferation of labels; was merely an analytical terminology to describe a duality that avoids the bias against the low-income sector inherent in the traditional-modern dichotomy. Both sectors were qualified as modern; both were the consequence of the urbanisation process that has been take place in different LDC's. Academics used the terms "large-scale" and "small-scale", but those terms were purely descriptive and no saying anything about why one sector is large-scale and the other is small-scale.<sup>3</sup>

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<sup>2</sup> BOZA, Beatriz. *The role of Indecopi in Peru: The first five years*. In: Peru's Experience in Market Regulatory Reform 1993 – 1998. Indecopi. Pág. 1.

<sup>3</sup> From ILO Mission, *Employment, Incomes, and Equality: An Strategy for Increasing Productive Employment in Kenya*, Geneva, 1972, pp. 5-8, 503-8

It was added that

*“one important characteristic of the formal sector is its relationship to the Government. Economic activities formally and officially recognised and fostered by the Government to enjoy considerable advantages. First, they obtain the direct benefits of access to credit, foreign exchange concessions, work permits for foreign technicians, and a formidable list of benefits that reduce the cost of capital in relation to that of labour. Indirectly, establishments in the formal sector benefit immeasurably from the restriction of competition through tariffs, quotas, trade licensing and product and construction standards drawn from the rich countries or based on their criteria. Partly because of its privileged access to resources, the formal sector is characterised by large enterprise, sophisticated technology, high wage rates, high average profits and foreign ownership.*

In addition, it was written that

*“The formal-informal analysis applies equally well to the agricultural sector. The parallels are obvious and striking. The division between operators with licenses and those who does not have licenses in urban areas is reproduced in agriculture between those who grow tea and coffee with official punishment and those who do it illegally. Their similarity to urban squatters is obvious – both are irresistibly drawn to real or perceived sources of wealth, despite legal restrictions of access.*

Some authors said that this concept is related to illicit activities in general (e.g. illicit traffic and drug production, smuggler, and the likes) and illicit

**Picture 1**

| TYPES OF ACTIVITIES OF THE INFORMAL ECONOMY |   |                         |   |                      |
|---|---|-------------------------|---|----------------------|
| TYPE OF ACTIVITY                            | MONETARY TRANSACTIONS   |                         | NON MONETARY TRANSACTIONS                                   |                      |
| Illicit activities                          | Commerce of robbed goods, traffic and drug production, contraband; swindle; and the likes   |                         | Drug Exchange, goods o contraband; robbery for personal use |                      |
|   | Tax's Evasion   | Tax's Elusion           | Tax's Evasion   | Tax's Elusion        |
| Illicit activities                          | Non declared illicit activities income coming from works by own account; pays and assets coming from declared works not related to allowed goods and services | Discounts to employees, | Goods and services Exchanges                                | Works" made in house |

Source: Schneider, F and D. Enste (2002), "Hiding itself in the shades, the growth of the underground economy" Subjects of Economy the IMF. Peruvian Institute of Economy.

But, from the institutional theory point of view, it is understood that institutions are those forms to think, to act and to feel, that members of a society share, and that allow them to interact under more or less predictable rules. Under this concept, the role of the institutions is to reduce the costs of transaction in the social and economic relationship. In this sense, Douglas North has stated that *“institutions would be the rules of game in a society; or formally talking, they are the human restrictions that model human*

*interaction*”<sup>4</sup>

On a first stage of the society, when social relations were less complex, the coexistence norms that rule the behavior between the members of the locality were based on consuetudinary rules. When the society relationship became more complex, it was needed the creation of rules that established how the market behavior should be, and, mainly how to make them effective, in order to be able to avoid social conflicts between the market agents. In this scenario, the State was born thought its power in order to create rules that will govern the economic and social relations, monopolising its execution based on the law regimen.

From this point of view, the informal economy can be defined as those:

*“activities that are based on illicit acts to be carried out (...) they are activities that intrinsically do not have a criminal content, but , in spite of being allowed activities in a country, have to use an illicit behavior to be carried out”.*<sup>5</sup>

Moreover, on an interview given by the anthropologist Jaris Mujica, who lived in one of the poorest and marginal districts of Lima, in order to analyse the informal market of cellular phones, he defined as:

*“The word Informal means all those practices, systems and orderings of local, economic and familiar structures that do not work within the structural legal formality, nor within the legal processes and either within the correct process of an Ethic’s Codes.”*<sup>6</sup>

It is possible to affirm that as a whole the word “informal” means that in a society there are activities which exist outside of the law. Thus, for example, the case of the “pirate taxi drivers”, whom without being registered offer a transport service to the public. As it is possible, its purpose is allowed as a way of living, and with their work simultaneously they are offering a public service; however, the ways they are using are illicit because they do not count on the respective license, probably without paying taxes and without following environmental regulations. Therefore, in spite of the allowed purpose, the activity as a whole is illicit because is unprotected by the law.

In the informal economy, economic agents can be observed from the supply side or the demand side. The formality for companies could mean a high cost that will reduce competitiveness to them, reason why it turns out more beneficial to stay in the parallel market. In addition, all supply responds to a demand, therefore, if an informal supply exists is because a group of consumers who buy at this market exists, probably because it is less expensive for them.

In this respect, Jaris Mujica says:

*“When these informal practices are no longer controllable or when the cost of the control is greater than the benefits the company receives, the let fight itself. As a consequence the interrelation between the informal and the formal begin to coexist until the point that some companies cannot subsist in the formality if they are not supported by informal practices”.*<sup>7</sup>

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<sup>4</sup> NORTH, Douglas. *Institutions, institucional change and economic performance*. Cambridge University Press, New York, 1995, pág. 3

<sup>5</sup> GHERSI, Enrique. *Informal Economy in America*. En: [www.anfe.or.cr/ghersi\\_economía\\_informal.htm](http://www.anfe.or.cr/ghersi_economía_informal.htm) (searched on January 26th, 2009).

<sup>6</sup> Interview published in El Comercio on September 27th, 2008

<sup>7</sup> Ibid

In that sense, the informality is not a problem that is exclusive of the developing countries, but also, of the developed countries. As an example, is only enough walking by the streets of Miami, Rome or Madrid where the informal ambulatory commerce is for immigrants a way of living.

### **2.1. *The cost of formality and informality***

According to Doing Business 2009 studies, in countries where it has been observed a more onerous regulation for the economic agents, and where the trade barriers are, the informality levels increased. In that sense, it has been affirmed that:

*“The investigations generally reveal that in countries with an overwhelming regulation display, an informal sector of high dimensions, higher unemployment rates and a slower economic growth.”*<sup>8</sup>

In that sense, the policies that the State rules in order to insert measurement to the economic agents at the formal sector will depend on their efficiency, but at the same time of giving legal norms that will govern the economic relations. For that reason, it has been indicated that the informality is not other thing that the inefficiency of the law.

*“The origin of the informality (...) is found in the inefficiency of the Law. In technical terms, we are informal by the cost of the legality. The politicians, the legislators, and much less, the lawyers do not understand that the law costs like any other thing (...) a prosperous country has a low law cost in comparison with the income of the population; a country that is not prosperous has a low cost”.*<sup>9</sup>

Following the classic economic theory, if we begin with the premise that the economic agents are rational in taking their decisions, making a cost - benefit analysis; then, it is possible to affirm that in an excessively onerous legal frame, the election of the agents to remain in the informal sector is rational, because it is less expensive for them, even if they take into consideration the possible fines and sanctions that the authority can impose to them if they are detected in the informality.

Therefore, Ghersi argues that the informality is not -as it is implicitly affirmed in some texts of sociology- part of the idiosyncrasy and Latin American towns' inheritance that comes from our indigenous and colonial past. In other words, the problem of informality existence does not have its foundation in a cultural problem, a religious dogma or an ethnic origin. The problem of the informality has its origin in the inefficiency of its own legal ordering and, finally, in the State that not creates an efficient normative frame that stimulates the companies to act and to operate within a frame of formality.<sup>10</sup>

### **2.2. *The cost of formality***

The costs of the formality are divided in two (2) groups: the costs of the formal sector access and the costs of permanence.

In relation to the access costs usually it is mainly related to the bureaucratic barriers that the own administration imposes. An example will allow us to illustrate it. In 1983, the economist Hernando De Soto<sup>11</sup> made a study taking as a model a dressing factory at an industrial zone of Lima. With this purpose, a work group was hired to begin and complete all the necessary legal proceedings without paying the bribe

<sup>8</sup> Doing Business 2009. World Bank

<sup>9</sup> GHERSI, Enrique. Op. Cit.

<sup>10</sup> Ibid

<sup>11</sup> De Soto, Hernando. *The other path*. El Barranco publisher, Third edition, Lima, 1986, pag. 173 y 174.

unless this was necessary to continue with the experiment. Results of the study showed that the whole process took ten (10) months and employees were asked for bribes in ten (10) opportunities, and in two (2) of them, they had to pay the bribe in order to get the licenses.

Additionally, a total of US\$ 194, 40 payments among rates and other requirements had to be done. The legal cost of registry was equivalent to thirty two (32) times a vital minimum wage. In comparison, another group was in charge to do the same procedure in New York and Florida, which took between 3 and 4 hours, respectively.<sup>12</sup>

Consequently, it is possible to argue that the costs of the formality depends on the normative frame, and also implies the following concepts: (i) the incurred expenses to obtain the qualifying titles to operate in the market; and (II) the cost of opportunity translated in the time and allocation of resources for the fulfilment of the legal exigencies.

On the other hand, once an economic agent has accessed to the formal market, its relation with the state regulations does not end there, it follows with a great number of norms and costs of remaining in the formality.

According to De Soto, the term, in a broad sense, includes the costs imposed directly by the legislation such as the taxes, the payment of labour rights, the accomplishment of certain administrative proceedings, and the likes. In addition, there are costs indirectly imposed by the legal institutions as the instability of the legal system and the inefficiency of the Justice System to solve the possible conflicts that happen between the economic agents. The permanence costs have been divided in groups: tax burden and tax bureaucratic regulations and bureaucratic or administrative processes requirements.

As it is known, taxes that a formal firm must pay are the main income source for developing countries. The control of the tax authority is easier when a formal firm is registered, but it does not happen with economic agents who operate informally. For that reason, the informal firms or firms that develop part of their activities informally have a competitive advantage forehead the companies that fulfil their taxes obligations.

According to the Doing Business study in 2009, in countries where the taxes are high and the benefits come from their taxes, the informality tends to be increased. For the economic agents, the decision of following or not tax regulations do not only depend on what onerous is the level of the tax rates, but also how complex are the administrative procedures for the fulfilment of the tax obligations.

*“The economies that are in the first level, and offered taxes facilities usually count on lower business taxes. In addition, they have simple administrative taxes processes for a tax declaration”.*<sup>13</sup>

For that reason, in order to struggle the informality stimulating the fulfilment of the tax obligations, the State must give an integral reform establishing low tax scales and the best legal frame.

On the other hand, there is another type of regulation that affects the costs of the permanence of the economic agents in the formal sector that is related to the labour costs.

In effect, in countries where the labour norms impose strong limitations for dismissals or work schedules, the companies are going to avoid completely the minimum labour norms, operating in the informality. In that sense, governments must look for equilibrium between norms that offer certain

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<sup>12</sup> Ibid

<sup>13</sup> Doing Business (2009) World Bank

protection to the workers avoiding social conflicts and those that allow the flexibility in the labour market with the objective of reducing the competitiveness at the formal companies and stimulate the growth of the informal sector.

In this regard, the study Doing Business 2009 says:

*“at the developing countries, it is frequent that the regulators are mistaken towards an end, the excessively regulations contribute to increase the informal sector. This model is evident in Venezuela and Bolivia: both have laws that prohibit the dismissal of workers by economic causes and both are between the five economies with a big percent of informal sectors...”*

The high labour costs, especially in the developing countries, cause formal firms to be less intensive in the use of the work factor for their production and, on the contrary, induce the agents who have capital assets to use it in an intensive way.

Finally, these costs of permanence could determine that the economic agents assign their resources to have a better knowledge of how following the regulations, which finally could give as a result that the permanence of the companies in the market depends not as much on the efficiency of its productive process, but how efficient is their relationship with the government”.

### **2.3. The informality cost**

There are two groups of costs for being informal. The first one is about the costs from the punishment that is imposed when the authority detects an informal activity, and the second one is referred to the impossibility of being benefited with the goods and services provided by the State.<sup>14</sup>

In effect, the informal agents provide certain amount of resources with the object of not being detected, and not being punished by the State. Generally, these punishments are hard enough and imply in most of the cases a considerable part of what they own (e.g. the informal manufacturers of pyrotechnics), reason why many agents destine part of their patrimony in bribes, which also stimulates the government corruption. Additionally, with the purpose of making up or attenuating their existence in the market, the companies reduce their efficient production for not being detected.

On the other hand, the informal agents are disabled to benefit from the services that the government offers in the market, specially, the services of the judicial and legal system and from security forces. In effect, considering that the informal activities are outside of the legal frame, the informal industrialists cannot completely have their own property rights. In that sense, in the informal sector, the transaction cost is increased due to the uncertainty of its execution.

In addition, other cost of the informality considered refers to the reduction in the internal investment and that originating one of the markets of capitals. In effect, according to an study made by De Soto, the families, who lacked a property title or had a unstable title in Peru, did not invested much in the construction of its own house until the property of the land -where they lived- was adjudged to them legally.

In relation to the reduction of the market’s investment, this one was pronounced in the following inefficiencies: i) the high interest rates that the informal economic agents paid; ii) the low value of appraisal destined to the informal activity, and iii) the difficulty to transfer the property and to create

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<sup>14</sup> LOAYZA, Norman. *The economics of the informal sector. A simple model and some empirical evidence from Latin American*. The World Bank, Washington D.C.

corporations of common shareholders.<sup>15</sup>

### 3. Impact of the informality in Peru

According to the arguments that have been said, the magnitude of the informal sector in Peru would be equivalent to a 35% of the PBI (GDP); whereas a 60% of the working hours are developed in the informal market.

From the social and economic point of view, Ghersi has concluded that the informality in Peru is high. If 60% of the **toiled** hour-men are in the informal sector, then the government only controlled four of every 10 hours that the Peruvians worked; this means that the Peruvians worked 6 hours outside the Law. In addition, in spite of its quantitative importance, of the preceding data, it is concluded that the informal sector has a low productivity, since 60% of the work only make 35% of the production.<sup>16</sup>

### 4. Origin of the informal economy in Peru: The migratory phenomenon

De Soto<sup>17</sup>, argues that the economic and social changes that have taken place in Peru, began with different migratory events that determined that the population of the country began itself to concentrate in the cities, whereas the rural areas were remained vacated virtually. In a period of almost 40 years, from 1940 to 1981, it is observed that almost 2.4 to 11.6 million of the urban population have been increased whereas the rural populations only increased in a third (4.7 to 6.2 million). This means that in 1940 two (2) of each three (3) Peruvians were living in rural areas, whereas in 1981 the figure is reversed and two (2) of each three (3) live in the city. It comes off from next chart:

Table N° 2

| Year | Urban Population (%) | Rural Population (%) | Total Population (Millions) |
|------|----------------------|----------------------|-----------------------------|
| 1940 | 35,4                 | 64,6                 | 7,1                         |
| 1961 | 47,4                 | 52,6                 | 10,4                        |
| 1972 | 59,5                 | 40,5                 | 14,1                        |
| 1981 | 62,2                 | 34,8                 | 17,8                        |
| 1993 | 70,1                 | 29,9                 | 22,6                        |
| 2005 | 72,6                 | 27,4                 | 27,9                        |

These migratory surges were stimulated by the deep differences that have existed between the city and the rural area, mainly in the provision of basic services and the opportunities of better life conditions. Thus, for example, in the study of De Soto, it is mentioned that the migrations were stimulated by the low rates of infantile mortality that existed in Lima, because of the improvement of the services and medical covers in the city.

Another factor that has been mentioned is the opportunity of a better salary, thus for example, it is mentioned that in 1970, a worker who left the rural area to be used as worker in the city received a high salary.

Another factor that explains the migratory phenomenon is the high degree of centralism that has

<sup>15</sup> LOAYZA, Norman. Op. Cit.

<sup>16</sup> GHERSI, Enrique. Op. Cit.

<sup>17</sup> DE SOTO, Hernando. Op. Cit.

existed in Peru during its republican history. In effect, the growth of the Public Administration, were an attractive reason for the country side settlers who looked for being close to the political decisions; as well as looking for opportunities to work like private sector or government employees.

Finally, according to De Soto, the most important factor that increases the migratory phenomenon is the difference in the educative level that existed between rural and the urban areas.

Nevertheless, the migration was not an easy change for the settlers who moved from rural areas, because they would find a hostile reality. In the first place, they had to face negative feedbacks for the traditional high class, that in the facts were translated in a social and racial segregation.

Perhaps, the most important obstacle that was faced by the immigrants was that the enterprise sector was not able to create the sufficient jobs for the increasing supply of manual labour of the rural immigrants. At the present time, the enterprise sector has the same problem for immigrants, the urbanisation-industrialisation matrix have not let work as a factor of attraction for the immigrants, who see in the city as an opportunity of integration to the modernity or as a way to have better jobs in order to improve the quality of life.

Nevertheless, not all the people have been able to have a job in the city, as an example, the following he has pointed:

*“In certain cases, it is common that the companies do not resort to the work market to contract workers, because they prefer to hire people “recommended” by their own workers, in order “to place” relatives, friends, countrymen, or others.”*

This determined that the marginalised immigrants of the formal labour market, by the incapacity of the state and the enterprise class, saw themselves in the necessity to auto generate their own entrance through the informal economic activities such as the ambulatory commerce, (e.g. pirate transport), etc.; which did not require of a specialised and described knowledge, but a lot of effort and sacrifice.

The phenomenon was denominated “the marginal pole of the economy” that includes economic activities made by immigrants whom not had the opportunity to be inserted satisfactorily to the layers of the labour and social formality. This is the group of people that it has been able to generate a deep change in the social, labour and economic relations in the conservative and traditional cities.<sup>18</sup>

From another point of view, informal sector appeared in Peru because the economic grow model that focused into exploit natural resources to export raw material likes minerals. Big corporations concentrated their activities in certain rural areas almost without linkages with other local activities. On the other hand, main manufacture and trade firms began to develop their production activities (60%) mainly in Lima, the capital of the country. This was the main cause of the migratory process and the origin of the informal sector in Peru.

## **5. Policies adopted for reducing the informal economy**

The government has taken a set of policies to reduce the informal activities. These include legal measures to reduce burden tax, administrative tax procedures, labour and product regulations and administrative processes for setting and operating firms.

Decrease of informality does not need the establishment of a strict punitive system because it will be

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<sup>18</sup> QUIJANO, Aníbal. *Notas sobre el concepto de marginalidad social*. CEPAL, Santiago of Chile, 1996. Quoted by Department of Economic Studies of Indecopi. Op. Cit.

fruitless if Public Administration does not additionally count on an adequate and effective supervision system that timely detects the violation to law. In addition, besides that, a merely repressive system could give to the informal economic agents an incentive to invest in sophisticated mechanism for covering up and increase the corruption of public officials.

The Administration should foster the passing of policies in order to insert informal agents to formal sector by reducing access and permanence costs.

The last Peruvian Administrations have made important steps. For example, in tax policy, The Government enacted the Legislative Decree 771 by means of it was created the named Unique Simplified Regime (RUS) which had as a general objective to simplify the fulfilment of taxing duties in favour of the citizens and make it easier its management for Tax Administration. The principal objective was to expand the number of taxpayers by incorporating into formality to persons and small business that were performing economic activities in the informal sector. The mechanism used was to establish a unique and flat payment for considering accomplished the obligations related to income tax and value added tax without needing the presentation of tax declaration neither registration of accountant books.

In the field of land property, the Government has created the Bureau for The Formalisation of the Informal Property – COFOPRI as public decentralised entity in charge of designing and enforcing (in an integral, comprehensive and fast way) a program for the formalisation of land property (land possession in state land property) and their permanence in the formality. In fact, is not only important to grant titles of property to the precarious holders as COFOPRI has done in the last years, but additionally it should be established necessary mechanisms in order to avoid formalised real states go back to informality. For instance, many programs in Africa for granting titles have been fruitless because new owners started to informally buy and transfer real states, because costs for transfer mean almost 10% of the value of the property and it takes ninety (90) days to get the registration. Besides that, the register publicity system granted little security to the property<sup>19</sup>. The policy of formalisation allows as a first step to access to the legal property but it also makes possible that many people can register an asset that permit to register and organise companies which can obtain loans from financial institutions.

In the labour market, the Government has passed the Law 28015, Law for the Promotion and Formalisation of Micro and Small Business, which seeks formalising this kind of enterprises by establishing a Special Labour Regime, which in principle has an objective to reduce some labour costs, the number of paid vacations, the value of indemnity for arbitrary firing, etc. The following table shows a comparison between the Special Labour Regime and The General Labour Regime:

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<sup>19</sup> Doing Business (2009). Country Profile for Peru. In: <http://www.doingbusiness.org/Documents/CountryProfiles/PER.pdf> (searched in January 27, 2009).

Table N 3

| REFERENCE             | GENERAL REGIME   | SPECIAL REGIME   |
|-----------------------|--|--|
| REMUNERATION          | S/. 500.00   | S/. 500.00   |
| WORKING DAY           | 8 daily hours or 48 hours weekly   | Same   |
| WORKING AT EVENING    | Minimum Vital Remuneration + extra 35%.<br>Form remuneration over S/. 675 the extra is not applied.  | If it were habitual, it would not be applied.  |
| DAY OFFS AND HOLYDAYS | 24 hours and payment for overtime.   | Same   |
| VACATIONS             | 30 days, reduction to 15 days for "buying of vacations".   | 15 days, reduction to 7 days.  |
| ARBITRARY FIRING      | 1 and 1/2 remuneration per working year.<br>Limit of 12 remunerations.<br>Fractions are paid in twelfth and thirtieth.   | 2 remunerations per working year.<br>Limit 6 remunerations. Fractions are paid in twelfth. |
| SPECIAL INDEMNITY     | 2 remunerations per year.<br>Fractions are paid in twelfth and thirtieth<br>This is only for workers of the General Regime that are retired and replaced for workers of the Special Labour Regime (article 57 of Law 28015). | This is not.   |
| SOCIAL SECURITY       | Worker is a regular  | Worker and manager are regular.  |
| PENSIONS              | The workers decide the pension system.   | Worker and manager additionally decide if they pay to pension system.                      |

Source and production: Dirección Nacional de la Micro y Pequeña Empresa  
<http://www.mypeperu.gob.pe/reglab.php?dn=5>

Taking as a base the Minimum Vital Remuneration, the new Special Labour Regime will mean a saving of costs for micro business, such as it could be observed in the following table:

Table N 4

| Issue                         | General Labour Regime | Special Labour Regime S/. Month |
|-------------------------------|-----------------------|---------------------------------|
| Minimum Vital Remuneration    | 500.00                | 500.00                          |
| Familiar Assignment           | 50.00                 |                                 |
| Gratification July & December | (1/12) 91.66          |                                 |
| CTS 8.33 %                    | (1/12) 53.47          |                                 |
| Vacations                     | (1/12) 45.83          | (1/24) 20.83                    |
| Social Security 9%            | 61.87                 | 43.87                           |
| TOTAL                         | 802.83                | 567.70                          |

Finally, in the field of administrative simplification of bureaucratic procedures, the Government has made advances by passing the following regulations:

- The Law of General Administrative Procedures – Law 27444 – which stipulates the following: (i) the principle of simplicity as an authority’s duty to establish easy proceedings and ask only for rational and proportional requirements; (ii) the obligation for passing a Unique Text of the Administrative Proceeding which contents all the proceedings before an entity; (iii) a proceeding of automatic approving subject to post supervision; (iv) a prohibition of requiring some determined documents such as one that the entity already obtained in a precedent proceeding; (v) the establishment of a limit for fixing fees of the proceedings that can not be superior to the real costs of the service.
- The Law of the Administrative Silence – Law 29060 – establishes a regime of positive administrative silence for:
  - (a) requirements in order to exercise pre-existing rights or develop economic activities that require previous authorisation from the Administration, subject to that public interests are not negative affected (e.g. public health, environment, natural resources, public safety, etc.)
  - (b) appeal for questioning the denying of a request or administrative acts, unless the cases described before; and
  - (c) proceeding in which the significance of the final decision does not have an impact on third parties.

## **6. Informality, consumer protection, competition defense and protection of intellectual property**

As it was appointed, Indecopi, as competition authority, acts in its role of arbitrator and promoter of the free market economy model, helping to correct the market failures (by *ex post* and *ex ante* intervention) that are able to restrict the functioning of the competitive process.

In that sense, in the following sections it will be analysed how Indecopi intervene in the markets from the perspective of its respective functions, keeping in mind the premise that both the formal agents and informal ones are under the scope of Indecopi’s competences.

### *Consumer Protection*

According to the Legislative Decree 716 – Protection of Consumer Act, a consumer is

*a natural person that, in acquiring, using and enjoying a good or contracting a service, acts in a field different to a professional and business activity; and, exceptionally, a micro enterprise that shows a situation of asymmetry of information with respect of its provider related to services and products not concerning with its object of business.*

In that sense, the problems related to the commercial relations established by the consumer with the providers (retailers) are focused on information asymmetries and, consequently, lack of suitability of the product. Indeed, in a consumption relation, the provider of a specific product has major and better information about its qualities and characteristics, and if that product is suitable in order to satisfy the consumer’s expectations. Through many modalities, the provider can hide relevant information to consumers, so it can produce a risk that sub-optimum commercial relations appear in the market, which would not have existed with adequate information. The inefficient result of this kind of transactions means that consumers will not allocate their limited resources for a better value in order to satisfy their unlimited needs.

As it can be inferred, the central issue is to form well-informed consumers and providers that believe in the advantage of acting with correction in the market by following the rules of loyal and free competition. This becomes particularly difficult if it is taken into account that there are a group of activities and agents that act in the informal sector; however, this does not mean that Indecopi does have competence to resolve conflicts arising from informal consumptions relations or on the fringes of the institutional (which does not include criminal offences).

Nonetheless, the Indecopi's main difficulty to solve conflicts derived from no formal transactions lies on proving the consumption relationship. In those transactions generally a proof of payment or any other document is not issued, so consumers are not able to prove they contracted a service or acquired a good from an specific supplier (even when it is informal). In general, these kind of transactions are closed by word or based in confidence when there have been previous operations.

Finally, it is important to point at the case of informal transactions, which consumers generally have the capacity to know about the risks derived from them, and even so, those consumers decide to assume them because of the lower price. Under this concept, the consumer could assume that any intention of complaining before Indecopi could be more burdensome in terms of money and time in comparison with the price that has paid for the good or service.

#### *Defence of Free Competition*

When there are cases that affect the competitive process through conducts of abuse of dominance and collusive practices, the competition authority will investigate and, eventually, punish, independently if the accused economic agent has activities in the formal or informal sector.

It is important to mention, as we did before, that an informal firm does not take advantage of scale economies because it precisely attempts to stay small in order to avoid of being detected and punished. Therefore, it is unlikely to observe in the market an informal agent that has dominance position. In the same way, because of the size of informal firms and the magnitude of their transactions, it is unlikely the incentive to engage in a collusive practice.

However, it is a paradox that in some cases it is possible to observe the presence of informal firms that have discouraged and made it failed the execution of anticompetitive conducts.

Indeed, in a case between the *Chamber of Commerce of Lima vs. the Transporters Owners of Trucks Union* (UNT Peru) and other trade transportation groups. The Technical Secretariat of the Commission observed that in the market of inter-cities transportation of persons and cargo was unlikely the existence of a collusion by the imputed formal transportation enterprises, because fixing a high concerted formal price would be discouraged by the lower informal price.

Therefore, there was a significant presence of informal suppliers so the formal ones would have the following options:

- (i) To try to establish collusive agreements and mechanism of supervision including everybody or the great majority of providers (informal or formal);
- (ii) If the previous option is not possible because of the intervention of the Administration or the high presence of informal, the formal agents resort to make lobby between the authorities looking for a protectionist regulation.
- (iii) If the previous option is not possible because the intervention of the Administration is declared unconstitutional by the Constitutional Tribunal or another reason, then it will be more beneficial for the formal agents moving to informal sector.

As it could be inferred, the markets with a significant presence of informal agents are those where generally, the barriers to entry are low and the supply side is atomised. Therefore, the Competition Authority should not worry about monitoring these markets since it is unlikely the existence of anticompetitive conducts.

Finally, it is important to appoint that we could not deny the importance of informal sector inside the market economy in Peru. In that sense, when a specific anticompetitive conduct is analysed, the authority of competition should not leave out the presence of informal agents, first, when it determines the relevant market and, consequently, the market power that let them cause a major injury for the general economic interest.

#### *Supervision of the Loyal Competition*

The special Commission is in charge of enforcing the Law of Repression of Disloyal Competition – Legislative Decree 1044 – that punishes the business and trading practices (including those from advertising activities) against the good faith that has to guide the free competition in the competitive markets.

As in the last section, the Commission has competence to resolve cases of disloyal competition, independently if the parts execute activities in the informal sector.

A conduct that is punished under this Act is the modality described in the article 14 of the Legislative Decree 1044 that refers to *the acts in violation of law*. This modality of act of disloyal competition punishes to the economic agents that gain a competitive advantage by breaking any imperative regulation; for instance, a specific rule that orders to obtain a certification to operate. Therefore, this supposition is directly applied to the economic agents that act in the informal sector and by virtue of that, they obtain a competitive advantage.

The repression of conducts of disloyal competition in the modality of *acts in violation of law* helps to discourage informality since competitors injured with that conduct are able to bring charges against the offender. And, it discourages that injured competitors reply by breaking the law, too.

In 2005, a case involved enterprises of GLP (LPG) commercialisation in cylinders. The Tribunal of Indecopi punished to Alfa Gas because it obtained an anticompetitive advantage breaking the Regulation for GLP Commercialisation, passed by Supreme Decree 01-94- EM. In this case, the regulation established that enterprises of GLP commercialisation were banned of trading their own products using the cylinders that belong to their competitors, unless that (i) they have subscribed an agreement of “co-responsibility” and (ii) the agreement have been put into knowledge of the Minister of Energy and Mines. In this case, it was proved that Alfa Gas would be using the distinctive cylinders of its competitors for the commercialisation of its own product.

#### *Supervision of Dumping*

A Commission is in charge of correcting distortions on competition because of importation with a price under dumping. If national producers considered that are injured with the importation of similar products with dumping prices, they could ask the Commission for an evaluation of the market in order to determine the existence of the practice and a damage that causes to national production, and then, to impose *antidumping* rights.

By means of the action of the Commission, it could be avoided that the national producers has the incentive to operate part of their activities in a no-formal way, in other words, breaking labour,

environmental, tax regulations in order to reduce their productions costs and, doing so, to be able to compete with the low prices of the imported products.

By the imposition of *antidumping* rights, the imported products will enter to the country in the same competitive conditions than goods produced in Peru by formal enterprises.

#### *Elimination of Bureaucratic Barriers*

There is a Commission which is in charge of monitoring acts and dispositions issued by the Public Administration that do not constitute an illegal barrier or an irrational barrier to the access or permanence in the market for private agents. These barriers are related to the demand of requirements and charging; or impediments and limitations to the performance of the economic agents.

In that sense, it is evident the importance of the functions of the Commission for the purpose of removing bureaucratic barriers that are able to constitute an obstacle for making the economic agents get into the market.

For example, there is a study about Rates of Access to Market 2007 – 2008 elaborated by the Technical Secretariat of the Commission and the Department of Economic Studies of Indecopi. In this study, it was observed that in relation to the passing of a TUPA only the 50% of a group of local governments had accomplished all the legal obligations related to this administrative tool (the first place was obtained by the Municipality of Callao).

Likewise, it was observed that 58,3% of the local governments fulfilled with creating the proceeding for the license of operation by issuing a municipal regulation, as it is established in the Law 27444. However, it was verified that the 70,8% of them had included that proceeding in their TUPA's. This means that 12,5% municipalities had not fulfilled with creating that proceeding according to law, but they had included it anyway. Finally, the 47,9% of the municipalities approved the tax for the right of licence proceeding by issuing a regulation; however, the 75% of them had already included in their TUPA's which means that 27,1% had included that tax without having approved it according to law.

To summarise, through resolving and monitoring actions, the Commission has taken care that the costs of access and permanence in the formal sector do not increase by actions of the Public Administration. In that sense, it has to be more beneficial for economic agents to keep themselves in the formality.

#### *Intellectual property and informality*

Indecopi has three (3) Directions of Intellectual Property: (i) The Direction of Distinctive Signs; (ii) The Direction of Investigation and New Technologies; and (iii) The Direction of Author Rights.

In the Peruvian market, it is possible to observe that a high number of no-formal transactions are related to the infringing of Author Rights, mostly, by reproduction of DVD's and CD's in audio and video called "pirate products".

For instance, in the following table it is possible to observe statistics estimations of piracy made by Department of Economic Studies of Indecopi in the report called "The phonographic industry and piracy in the Peruvian Market: 1999 – 2003":

Table N° 4

| AÑO  | CD (Unidades) |           |           | KCT (Unidades) |         |           | INDICE DE PIRATERIA |               |                |
|------|---------------|-----------|-----------|----------------|---------|-----------|---------------------|---------------|----------------|
|      | Mb            | V         | d         | Mb             | V       | d         | Indice (c=0%)       | Indice (c=5%) | Indice (c=15%) |
| 1999 | 2 379 508     | 3 348 532 | n/d       | 33 589 211     | 233 362 | n/d       | 90,94               | 90,51         | 89,51          |
| 2000 | 6 857 776     | 1 504 871 | 858 236   | 13 594 973     | 451 788 | 1 066 563 | 90,45               | 89,95         | 88,77          |
| 2001 | 22 933 180    | 2 366 828 | 2 298 305 | 26 013 987     | 203 447 | 226 436   | 94,64               | 94,36         | 93,70          |
| 2002 | 50 849 262    | 886 549   | 1 635 396 | 18 935 802     | 64 400  | 148 434   | 98,18               | 98,08         | 97,85          |
| 2003 | 81 995 398    | 826 606   | 2 523 566 | 13 315 538     | 18 267  | 127 180   | 98,72               | 98,65         | 98,48          |

Made by Department of Economic Studies of Indecopi

Where: “Mb” represents the total imports of CD’s and/or cassettes unrecorded; “V” represents legal sales of CD’s and/or cassettes which recorded in the national market; “d” represents the total of confiscated stuff by the authorities; “c” represents the percentage of unrecorded CD’s that were used to carry out reproductions different to musical purposes. In that sense, it can be inferred from previous data that by 2003 it existed a level of piracy between 98,5% and 98,7%.

The Direction of Author Rights is in permanent work in order to reduce commercialisation of informal audio and video pirate copies. Thus, during 2004, that Direction executed almost 40 operations in different places where pirate products were sold illegally for an amount of US\$ 21 million.

However, the task for eliminating the informality in this sector goes on, but it is complicated because the network of production and distribution of this illegal business has high levels of sophistication, so they are able to reach a great mass of consumers. This has motivated that formal Peruvian enterprises use the same ways of distribution in order to spread their “original” products to a lower price so they can attract part of the consumers of piracy.

Finally, it is important to stress on the efforts of Indecopi in fostering some campaigns which have had the objective of catching the consumer’s interest about damage of piracy in authors and the State. Examples of these campaigns are “Antipiracy Crusade” and “The Movie Theater Day”.