

Unclassified

DAF/COMP/GF/WD(2012)39



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

24-Jan-2012

English - Or. English

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

DAF/COMP/GF/WD(2012)39
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Global Forum on Competition

COMPETITION AND COMMODITY PRICE VOLATILITY

Contribution from Peru

-- Session I --

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

JT03314764

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COMPETITION AND COMMODITY PRICE VOLATILITY

-- Peru --

1. Background

1.1 *In recent years has there been significant volatility in the prices of commodities that are important to the general population in your country? Please briefly provide details (e.g., among others, on the product(s), market(s) and adjacent market(s) concerned and the magnitude and duration of this volatility, be it prices going up or down).*

1. Peru has been affected by the unexpected and sustained increase in international prices of major agricultural commodities¹ and crude oil. The volatility in prices has brought a negative impact on food security and an increase in domestic price levels².

2. The instability in the international price of products such as rice, wheat, soybean oil and sugar caused a strong impact in the internal production costs of packed rice, bread, noodles, wheat flour, edible vegetable oil and refined sugar. As a consequence, between 2007 and 2008 consumer prices exhibited large increase; for instance, in this period the annual consumer price of edible vegetable oil increased in 44,3%, packed rice in 27,2%, wheat flour in 19,5% and bread in 11,8%. A similar fluctuation was observed in 2011, when international prices increased again.

3. The international price volatility showed the presence of problems related to the presence of asymmetries in the pass-through of price fluctuations into the domestic market, mainly against positive shocks³. For example, even though since mid-2008 international prices registered a sharp fall, domestic prices only showed a slow decrease.

4. So far the only market in which Peruvian government has decided to implement any measures to mitigate the effects of the commodity price instability is crude oil⁴. In 2004, the government implemented a stabilization fund to mitigate the negative effects generated by the rising price of crude oil in the domestic

¹ According to FAO et al. (2011), food prices reached their highest nominal prices between 2007 and 2008, and later experienced a major correction in mid-2008. In 2010 food prices rose again quickly, and remain high and volatile up to date. Joint report available in: http://www.theaahm.org/fileadmin/user_upload/aahm/docs/Interagency_Report_to_the_G20_on_Food_Price_Volatility.pdf. Accessed January 3, 2012.

² According to BCRP (2011), imported inflation associated with the increase in food prices and fuel contributed to the temporary falling of inflation above the target range in 2007, 2008 and 2011. Available report in: <http://www.bcrp.gob.pe/eng-docs/Monetary-Policy/Inflation-Report/Inflation-Report-September-2011.pdf>. Accessed January 3, 2012.

³ Upward cost shocks are passed through faster than downward cost shocks.

⁴ For more detailed information about the stabilization fund, please refer to: <http://www.bcrp.gob.pe/docs/Publicaciones/Revista-Moneda/Moneda-132/Revista-Moneda-132-04.pdf>. Accessed January 3, 2012.

market⁵. The fund should have had a temporary term, but became permanent because the volatility in prices remained unchanged. It is important to highlight that the maintenance of this fund represents a high fiscal cost to Peruvian government⁶.

5. Lastly, it is clear that Peru, as a net importer of food and crude oil, is highly exposed to fluctuations in commodity prices. However, it is worth noting, for instance, that the increase in the price of raw materials also had a positive impact for the country, because it boosted the growth of mining exports of gold, silver and copper, in addition to attracting new investment in exploration and exploitation. Actually, the mining sector became the main source of foreign currency and tax revenues for the country.

1.2 Are the price volatility in these commodities, and the causes of that volatility, global, regional or domestic?

6. Although, the National Institute for the Defense of Competition and the Protection of Intellectual Property (Indecopi) has not conducted a general investigation to explore the causes of price instability, it is well-known that many of the facts that contributed to price volatility had a global dimension⁷. Among the most cited factors are imbalances in supply and demand, the devaluation of the U.S. dollar, the rise on energy prices, increased global demand for bio fuels, adverse weather conditions and protective policies adopted by some exporting and importing countries.

7. On the other hand, as a consequence of the international price instability, an asymmetric pass-through on prices has been evidenced in certain markets in Peru. Possible explanations for this situation range from menu costs, consumer inertia, transaction costs, explicit or implicit collusion and inventory management by producers or sellers; however, none of these hypotheses have been studied or tested in depth yet.

1.3 Does your agency have any ongoing / pre-emptive monitoring activities in relation to these sensitive commodities? For example, do you routinely monitor prices, quantities or behaviours in these markets (both domestic and foreign markets)?

8. Since 2010, Indecopi conducts a monthly monitoring report of consumer and wholesale prices. This report shows the variations in prices of certain food, construction, manufacturing and fuel products. To monitor the behaviour of consumer and wholesale prices, the series are seasonally adjusted and corrected for fluctuations related to inflation. The aim is to detect those products that show sustained deviations from their historical real prices.

9. The products are classified into three groups according to their degree of deviation from their past trend. The first group (“red group”) consists of products that in the past three months showed deviations in their average prices of more than two standard deviations. The second group (“amber group”)

⁵ Another measure implemented was the reduction of the excise tax on fuel.

⁶ In December 2011, the amount of fiscal transfer was S/. 610 million (US\$ 226 million). See December 23, 2011 <http://elcomercio.pe/economia/1351947/noticia-fondo-combustibles-recibio610-mlls-evitar-alza-precios>. Accessed January 4, 2012.

⁷ For more detailed information about of factors contributing to the price instability, please refer to: FAO *et al.* (2011) http://www.theaahm.org/fileadmin/user_upload/aahm/docs/Interagency_Report_to_the_G20_on_Food_Price_Volatility.pdf;
USDA (2008) http://www1.eere.energy.gov/biomass/pdfs/global_agricultural_supply_and_demand.pdf ;
EIA (2007) <http://www.eia.gov/forecasts/steo/special/pdf/2007-oil-prices.pdf> ;
EIA (2006) http://www.eia.gov/oiaf/aeo/otheranalysis/aeo_2006analysispapers/efhop.html.

comprises those products that have deviated from their average prices in more than two standard deviations for one or two months. The last group is composed of products which may not have shown deviations but are of major concern to the general population.

10. The results are reported to the Defense of Free Competition Commission and the Anti-dumping and Countervailing Duties Commission of Indecopi which further assesses the need of a more in depth investigation. Although we do not monitor international prices, reports published by the Food and Agricultural Organization and the World Bank are routinely reviewed.

2. Competition Law Enforcement & Formal Investigation

2.1 *Please provide a brief overview of significant competition law enforcement matters that your agency has undertaken in relation to commodities including:*

11. In the last decade, INDECOPI has initiated several investigations and procedures for suspected anticompetitive practices⁸ related to commodity products. Some significant evaluations are listed below.

2.1.1 Cartels and horizontal agreements

- *Sugar (2004 & 2006) - Price agreement between competitors.* Due to a price increase of sugar, an *ex officio* investigation was initiated in 2004 in order to determine the existence of a national cartel on sugar market. The investigation concluded that the upward pressure on sugar prices was caused by a reduction in output⁹ and no company under investigation was fined. Later, in 2006, a new investigation was initiated due to some suspected anticompetitive behaviour. Nevertheless, the procedure showed no evidence of a horizontal agreement, but an asymmetric behaviour of the companies under investigation¹⁰.
- *Cotton (2004) - Price agreement between competitors and refusal to deal.* After a complaint filed by a cotton producer, an administrative procedure was initiated against four textile manufacturers for an alleged agreement to set the purchase prices of cotton and to deny the cotton ginning service to cotton producers. The Defense of Free Competition Commission found that most of the defendants did not deny the ginning service and that variability and increases of prices do not support the hypothesis of collusion by themselves. Accordingly, none of the defendants was fined. The Defense of the Competition Chamber of Indecopi upheld this decision.
- *Palm oil (2005) – State aid.* The General Secretariat of the Andean Community authorized Peruvian government to apply measures to imports of palm oil from Colombia, since its government had established a subsidy fund for Colombian palm oil exporters. Although the procedure was held by the General Secretariat of the Andean Community, the Defense of Free Competition Commission of Indecopi had an active participation in developing the point of view of the Peruvian government.

⁸ Currently, there is currently no merger control system in Peru, except for the electricity sector. Furthermore, price controls or actions to regulate prices are not allowed under Peruvian law.

⁹ In turn, this reduction was caused by water shortage, cessation of operations of some producers, storage for export and lower imports.

¹⁰ Higher prices observed in this period would have been the result of a reduction in output caused by water shortage and cessation of operations of some producers.

2.1.2 *Vertical restrictions*

- *Cement (2010) – Exclusionary practice.* There is a still ongoing procedure that has been opened by an alleged vertical restraint in the form of boycott and concerted refusal to deal in order to impair the opportunities of a new competitor in the regional cement market. The procedure is still pending decision.

2.1.3 *Abuse of dominance actions*

- *Liquefied petroleum gas - LPG (2002 & 2006) – Refusal to deal.* After a complaint filed by a distributors association, an administrative procedure was initiated against a state-owned oil company and a company that contracted its storage capacity for LPG. The Defense of Free Competition Commission found that both defendants, acting together, discriminated against members of the association. Therefore, the Commission found the defendants liable and fined them. The Defense of the Competition Chamber of Indecopi upheld this decision. Later, in 2006, a procedure was initiated against an oil company due to an alleged refusal to sell LPG to members of a LPG distributors association. The Defense of Free Competition Commission found that, despite having a dominant position, the defendant contracted with several members of the association. Accordingly, the defendant was not found liable.
- *Jet fuel (2006) – Refusal to deal.* After a complaint filed by a wholesaler, an administrative procedure was initiated against a state-owned oil company due to an alleged refusal to deal “Turbo A1” jet fuel. The Defense of Free Competition Commission found that despite having a dominant position and that the refusal to deal was not justified, no anticompetitive effects were caused in the relevant market. Therefore, since an essential element of the practice was missing, the defendant was not found liable.
- *Wheat flour & Oats (2003) – Resale price maintenance: ceiling.* A complaint was filed against major wheat flour and oat company by an edible wholesaler, because the former was advertising price caps to its wheat and oat bags, preventing wholesalers to charge higher prices. Considering that the complainant failed to meet the legal requirements to file a complaint and that no evidence of negative impact on competition and consumer welfare was submitted, our Defense of Free Competition Commission decided not to initiate an administrative procedure.
- *Coffee (2005) – Exclusive dealing.* A complaint was filed by an edible wholesaler against a company that was allegedly requiring its distributors not to sell its competitor’s coffee. Considering that the complainant failed to provide any information supporting the hypothesis of dominant position of the provider, our Defense of Free Competition Commission decided not to initiate an administrative procedure.

2.2 *Has your agency undertaken a market study into any commodity or commodities? Please explain what triggered the market study, the substance of the allegation, the analysis undertaken and the remedies imposed (if any).*

12. Indecopi developed five market studies (fuel¹¹, wheat, rice, fertilizer and edible vegetable oil), with the aim of analyzing the competitive structure of the selected markets, which were strongly affected by the impact of the volatility of international prices, generating an unexpected increase in domestic prices.

¹¹ The fuel market study was carried out by external consultants at request of Indecopi (José Távora and Arturo Vásquez, 2007, *La industria del petróleo en el Perú: Contexto regional, condiciones de competencia y asimetría en las variaciones de los precios de los combustibles*).

13. The main findings were: (1) a strong dependence of inputs imported by the domestic market, situation that increased the exposition of the domestic market to international fluctuations, (2) domestic prices have a faster response to an increase than to a decrease in the international price, and (3) the existence of few producers with a large market share (an exception was found in the rice market, where there are a large number of little producers).

2.3 *Has your agency received request from governments or other parts of society to formally investigate commodities markets or request for the competition authority to put downward pressure on prices where there has not been information or evidence suggesting anticompetitive behaviour? What was the nature and circumstances of the request and how did your agency respond?*

14. Indecopi has received requests from government authorities to formally investigate several markets, some of them related to commodities. Nevertheless, whenever there is no information or evidence suggesting anticompetitive behaviour, the Defense of Free Competition Commission and its Secretariat have duly responded that, even though they are always monitoring those markets, they have no authority to intervene in the free development of markets, unless there is any evidence or information suggesting anticompetitive behaviour.

15. For instance, after a complaint from the Ministry of Agriculture, in early 2008 a Congressman asked Indecopi about the measures taken to control a supposed cartel on several products, including corn, wheat and sugar. Indecopi responded that a sole increase in prices did not constitute sufficient evidence in order to initiate an administrative procedure against the companies involved. Also, Indecopi informed that, according to statements of experts in the media, the increase of the prices of such products could be caused by several facts, including an increase on the demand of those products for manufacturing biofuels.

3. Advocacy Opportunities and Challenges

3.1 *Has your agency the opportunity to improve the efficiency and effectiveness in commodities markets through advocacy?*

16. Indecopi has not had the opportunity to improve the efficiency and effectiveness in commodities markets through advocacy yet.

3.2 *Has your agency been confronted by a government proposal to address pressing concerns about commodity prices that did impede competition (or would have impeded competition if it had been introduced)? What was the nature of the problem that the government was seeking to address? What was the timing and political constraints upon your opportunity to provide advocacy? What advice did the agency provide and what was the result?*

17. Indeed, Indecopi has received government proposals (mainly bills) that address concerns about prices in several markets, some of them related to commodities. Nevertheless, Indecopi has always maintained its technical approach to all of those proposals, according to its legal duties.

18. For instance, in 2009 a Congressman asked Indecopi its technical opinion about a bill that sought to protect Peruvian production and consumption by abrogating regulations that increased tariffs to subsidized products from industrialized countries. Considering the distortions over the markets that could result from an increase in tariffs and that no economic research supported the proposal, Indecopi responded that, if approved, the bill could generate unreasonable entry barriers, and therefore an increase in prices and harm to consumers' welfare. The bill was ultimately rejected.

19. Similarly, in 2011 a Congresswoman asked Indecopi its technical opinion about a bill that sought to strengthen Peruvian steel industry by imposing higher tariffs to steel imports. Taking into account the

commodity nature of steel and that there would be alternative options to strengthen our steel industry without an unreasonable constraint to competition, Indecopi responded that, if approved, the bill would only cause harm to consumers welfare, because of a restraint in the supply and the higher prices they would have to pay. The bill is still pending approval or rejection.

3.3 *Please describe any pre-emptive steps available to your agency to: i) Reduce the risk that commodity price volatility becoming a problem in your country? ii) Reduce the risk that governments or public societies seek policy responses to problematic commodity process volatility that would impede competition?*

20. The main pre-emptive step employed by Indecopi is preliminary investigation. The monthly newsletter which monitors consumer and wholesale prices may be employed to suggest which product or market needs more attention. Advocacy is another pre-emptive step that may be used to mitigate the potential risks associated with the instability of commodity prices.