

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

**LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM - Session I:  
Informal Economy in Latin America and the Caribbean: Implications for  
Competition Policy**

**- Contribution from Peru -**

**18-19 September 2018, Buenos Aires, Argentina**

The attached document from Peru is circulated to the Latin American and Caribbean Competition Forum FOR DISCUSSION under Session I at its forthcoming meeting to be held on 18-19 September 2018 in Argentina.

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**JT03435405**

## *Session I: Informal Economy in Latin America and the Caribbean: Implications for Competition Policy*

### **– Contribution from Peru<sup>1</sup> –**

#### **1. Introduction**

1. With over half of its workers in the informal economy (55%; CEPLAN, 2016),<sup>2</sup> Peru's level of informality is among the most pervasive in the region, posing a major challenge for the proper roll-out and delivery of public policy. Specific examples related to competition policy that Indecopi has noted include the inter-provincial public transport sector in the provinces and the river port infrastructure sector, where levels of informality are fairly high.
2. Accordingly, the Peruvian experience could prove instructive in terms of how Indecopi has approached both the enforcement of its various rules, including those relating to free competition, in an economy where informality is high, and the implementation of its initiatives to encourage informal agents to make the shift into the formal economy.

#### **2. The informal economy in Peru**

3. Informality is a broad, dynamic concept that includes a set of activities that can be divided into three strands: (i) "pure" tax evasion, when agents, workers and businesses fail to fully report earnings from businesses that are registered and recorded in the national statistics; (ii) the irregular economy, which includes the total production of lawful goods and services in small, unregistered establishments; and (iii) illegal activities, which refers to the unlawful production and distribution of goods and services (Dryden Witte, 1996).<sup>3</sup>
4. Studies have identified two pathways to informality: "exclusion" and "exit". First, there are the "exclusion" factors where a labour market segmented by formal and informal arrangements prevents both informal workers from being able to be employed in the formal sector, and micro and small enterprises (MSEs), which employ a high number of workers, from becoming formalised. For example, ComexPerú estimated that, in August 2017, 80%

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<sup>1</sup> This document was drawn up by the Department of Economic Research at the National Institute for the Defence of Competition and the Protection of Intellectual Property (Indecopi) and does not necessarily represent the opinion of the multi-member bodies that make up the various decision-making bodies of Indecopi.

<sup>2</sup> CEPLAN (2016). *Economía informal en el Perú: Situación actual y perspectivas* [Informal economy in Peru: Current situation and outlook]. National Strategic Planning Centre of Peru (CEPLAN). May 2016.

<sup>3</sup> Dryden Witte, A. (1996). *Beating the System?* in Pozo, Susan (editor). *Exploring the Underground Economy: Studies of Illegal and Unreported Activity*. Kalamazoo, MI: W. E. Upjohn Institute for Employment Research, pp. 129-145.

of MSEs in Peru were informal.<sup>4</sup> Complex and excessive tax and/or regulatory burdens are likely to be the chief factor behind this (De Soto, 1986).<sup>5</sup> Second, there are “exit” factors where workers and businesses make implicit cost-benefit analyses to determine the pros and cons of formalisation,<sup>6</sup> offering an indictment of the quality of the State’s services and law enforcement capability (Perry *et al.*, 2008).<sup>7</sup>

5. According to ILO Recommendation No. 204,<sup>8</sup> in developing countries, most people enter the informal economy not by choice (“exit”) but as a consequence of a lack of opportunities in the formal economy (“exclusion”). Tello (2014)<sup>9</sup> estimated that, in Peru, 73.8% of workers of the employed, economically active population in 2014 were performing informal activities not as a matter of choice but because it was their only employment option.

6. The need to determine the scale and drivers of informality in Peru became hugely important when work to analyse the phenomenon began. Although initially focused on measuring the size of the informal economy in terms of its contribution to official Gross Domestic Product (GDP), investigations threw up methodological limitations when it came to assessing how much of the added value generated by the informal economy was captured in official GDP figures. As a result, informality is commonly estimated in terms of its impact on the labour market. The measurements have regard to a “legal” definition stating that an informal worker is a worker with no social security cover and to a traditional definition stating that an informal worker is a worker in a firm with five or fewer employees, an unskilled self-employed person, or a domestic or unpaid family worker (Chong *et al.*, 2008).<sup>10</sup> Machado (2014)<sup>11</sup> considers the legal definition to be superior to the traditional

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<sup>4</sup> El Comercio (08.08.2017). ComexPerú: Mypes siguen aumentando, pero formalización no avanza [Numbers of MSEs continue to rise, but formalisation does not]. Available at: <https://elcomercio.pe/economia/negocios/informalidad-micro-pequenos-negocios-peru-noticia-noticia-448518>.

<sup>5</sup> De Soto, H. (1986). *El otro sendero* [The other path]. Lima: Editorial El Barranco.

<sup>6</sup> On this pathway, both SMEs and independent workers are likely to decide that the benefits of formality are outweighed by the costs because unskilled workers take the view that their wages in the formal sector would probably be lower as a result of statutory deductions (tax payments, social security contributions, pension contributions). Additionally, where enforcement is poor, businesses and the most highly skilled workers may see an opportunity not to declare their full income in order to avoid or reduce their tax burden.

<sup>7</sup> Perry, G., Maloney, W., Arias, O., Fajnzylber, P., Mason, A. and Saavedra-Chanduví, J. (2008). *Informality: Exit and exclusion* Bogotá, Colombia: World Bank.

<sup>8</sup> ILO (2015) Recommendation No. 204 concerning the Transition from the Informal to the Formal Economy Geneva, Switzerland: International Labour Conference, 12 June 2015.

<sup>9</sup> Tello, M. (2015). ¿Es la informalidad una opción voluntaria o la última alternativa de empleo en el Perú? [Is informality a free choice or a last resort for employment in Peru?]. Social and Economic Research Consortium (CIES).

<sup>10</sup> Chong, A., Galdo, J. and Saavedra, J. (2008). Informality and Productivity in the Labour Market in Peru. In: *Journal of Economic Policy Reform*, Vol. 11, No. 4, pp. 229-245.

<sup>11</sup> Machado, R. (2014). *La economía informal en el Perú: magnitud y determinantes (1980-2011)*. *Apuntes: Revista de Ciencias Sociales*, 41(74), 197-233 (The Informal Economy in Peru: Magnitude and Determinants, 1980-2011).

one because the latter cannot explain the upward trend in informal employment during the reform period in Peru in the early 1990s.

7. Accordingly, where Peru is concerned, the most widely accepted definition of the informal economy is the one put forward by the National Institute of Statistics and Information Technology (INEI) (2014),<sup>12,13</sup> which defines it as: *a set of economic activities performed by workers and production units (urban and rural businesses) that fail to comply with the regulations laid down by the State (whether registration, tax payments, etc.) in respect of the exercise of their activities.*

8. Moving onto the causes of informality in Peru, Loayza (2008)<sup>14</sup> argues that it is down to a combination of factors associated with inadequate public services, high taxation and regulatory burdens, and the incapacity of the State to perform oversight and enforcement duties, all of which become more marked in an environment where the population is poorly educated, there are strong demographic pressures and the primary structures of production are the ones that employ the most people. To these factors we must add taxation, corruption (CEPLAN, 2016) and labour costs (Machado, 2014; Pagés, 2016).<sup>15</sup>

9. According to the INEI,<sup>16</sup> in 2016, informality was clustered around the following activities: agriculture and fisheries (87%), restaurants and accommodation (41%), transport and communications (32%), construction (23%) and commerce (19%); these are also the activities where the levels of labour informality are highest (agriculture, 97.2%; transport, warehousing and communications, 80.5%; construction, 75.7%; and commerce, 74.3%).<sup>17</sup> Accordingly, a large volume of the goods and services produced in these sectors tend to be informal.

10. The various measurements show that the informal economy behaves counter-cyclically, expanding in times of economic crisis and contracting during growth spurts (Machado, 2014). One of the first studies of this phenomenon in Peru (Saavedra and Nakasone, 2003)<sup>18</sup> estimated that, in Metropolitan Lima alone, informal employment accounted for 54.9% of total employment in 1986, rising to 59.3% in 1992, matching the period of economic crisis and hyperinflation that the country experienced during those years. Later, estimates for 1996 from the Ministry of Labour and Employment Promotion (MINTRA) drawn from INEI data placed it at 62.6%, peaking in at 65.1% before beginning

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<sup>12</sup> Based on the concept as defined at the International Conference of Labour Statisticians (ICLS) in 2003 (INEI, 2014).

<sup>13</sup> INEI (2014). Producción y empleo informal en el Perú [Production and informal employment in Peru]. Cuenta Satélite de la Economía Informal 2007-2012. INEI.

<sup>14</sup> Loayza, N. (2008). Causas y consecuencias de la informalidad en Perú [Causes and consequences of informality in Peru], in *Revista Estudios Económicos*, Central Reserve Bank of Peru, 15, pp. 43-64.

<sup>15</sup> Pagés, C. (2016). Formalidad laboral en el Perú: Situación actual y perspectivas. [Labour formality in Peru: Current situation and outlook.]

<sup>16</sup> INEI (2017). Producción y empleo informal en el Perú. [Production and informal employment in Peru.] Cuenta Satélite de la de Economía Informal 2007-2016. P. 74.

<sup>17</sup> CEPLAN (2016). *Op. cit.*, p. 16.

<sup>18</sup> Saavedra, J. and Nakasone, E. (2003). Una nota sobre la informalidad y el Autoempleo en Lima Metropolitana 1985-2000 [A note on informality and self-employment in Metropolitan Lima 1985-2000], p. 7.

to fall in response to growth in the Peruvian economy.<sup>19</sup> In terms of informal output, based on the model given in *International Futures*,<sup>20</sup> CEPLAN (2016) estimated that, in 2010, the informal sector in Peru represented 19% of GDP, and forecast that it would fall to 13.8% by 2030 and around 6% by 2050.

11. In view of the scale of informality in Peru, the experience of formal businesses' is that informal businesses are highly competitive cost-wise because informality does not incur the costs involved in formality. Thus, the greater the costs evaded, the greater the capacity of informal businesses to compete, set lower prices and secure greater market share (Beltrán *et al.*, 2018).<sup>21</sup> In that regard, the First National Business Survey carried out by the INEI in 2014 concluded that 39.5% of businesses regarded informality as one of the three main factors restricting business growth.<sup>22</sup> Similarly, in 2014, 81.2% of businesses were of the view that there was informal competition for their main product and, where structures of production were concerned, the greatest percentage of informality occurred in respect of micro businesses (84.2%) and was lower for medium-sized and large businesses (65.3%).<sup>23</sup>

12. Note that informality rises when the costs of complying with a country's legal and regulatory framework is higher than the benefits it offers (Loayza, 2008). A cost is entailed to achieve and to maintain formalisation; the same is true of labour costs. That is why a business interested in recruiting a worker on a formal basis must first establish whether the fruits of the employment relationship (value of the product generated by the worker) are sufficient to pay the worker (wages or salary), the State (non-wage costs) and the business itself (profits) on the basis of a salary or wages that must be equal to or greater than the minimum wage. Based on data concerning labour legislation in Latin America and the Caribbean (LAC) for 2013, Pagés (2016) took the view that non-wage costs in Peru amounted to more than 60% of a worker's annual wage, above the average for the LAC (48%). The costs include the employee's social security payment, the employer's social security payment, leave, bonus and severance pay.<sup>24</sup>

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<sup>19</sup> Estimated national figures from MINTRA were that the proportion of the economically active population employed in the informal sector fell from 79.9% in 2007 to 72.0% in 2016. MINTRA (2017). Informe Anual del Empleo en el Perú 2016 [Annual Report on Employment in Peru 2016]. Peruvian Ministry of Labour and Employment Promotion.

<sup>20</sup> Drawn up by the Frederick S. Pardee Center, University of Denver, United States. CEPLAN (2016). *Op. cit.*, p. 31.

<sup>21</sup> Beltrán, A, Chong, A. and Montoya, M. (2018). Los efectos de la informalidad en la productividad de las empresas [The effects of informality on business productivity]. Foco Económico. A Latin American Blog on Economics and Politics Available at: [http://focoeconomico.org/2018/07/27/los-efectos-de-la-informalidad-en-la-productividad-de-las-empresas/#\\_ftn2](http://focoeconomico.org/2018/07/27/los-efectos-de-la-informalidad-en-la-productividad-de-las-empresas/#_ftn2).

<sup>22</sup> INEI (2016). La informalidad es el principal factor que limita el crecimiento de las empresas [Informality is the biggest constraint on business growth]. Available at: <https://www.inei.gob.pe/media/MenuRecursivo/noticias/nota-de-prensa-n140-2016-inei.pdf>.

<sup>23</sup> In that regard, the Chamber of Commerce of Lima (CCL) (2017) states that “accessing the road infrastructure, public services such as water and electricity, and public safety, without having contributed at all involves a cost that is ultimately assumed by formal businesses.” LA CÁMARA. (2017). El Impacto de la Informalidad [The Impact of Informality]. La Revista de la CCL. 30 October to 5 November 2017, No. 800.

<sup>24</sup> Pagés, C. (2016). *Op. cit.*, p. 23.

13. We cannot disregard the fact that the informal economy generates considerable costs for individuals, businesses, government and society as a whole. It means low wages for individuals and no social health protection, job security or pensions. For businesses, it means low productivity. For the government, it results in insufficient revenue to spend on public services because of tax evasion, and, for society as a whole, it fosters a culture of non-compliance with the rules governing safety, the environment and intellectual property rights, and encourages a culture of corruption through the side-stepping of regulations and payments to government.

14. Another effect of the high level of informality seen in Peru is its impact on economic growth: a large informal sector generates lower growth in productivity.<sup>25</sup> Loayza (2008) estimated the effect of informality on Peruvian economic growth and worked out that an increase in a standard deviation in various informality indicators led to a reduction of between 1 and 2 percentage points in the rate of *per capita* growth in GDP. However, the impact of the informal sector on employment is more ambiguous: although the choice to work in the informal sector would appear to be prompted by a scarcity of better protected and better paid jobs, it is also true that it acts as a safety-net for unskilled workers who have very few assets with which to establish formal businesses.

15. It is therefore important to improve the legal framework, and the quality and availability of public services, in order to generate greater incentives for formalisation and greater growth. Similarly, in Machado's view (2014), the goal of achieving formalisation of a significant proportion of informal businesses requires an appropriate combination of incentives and penalties because interventions to reduce costs by cutting red tape and/or tax rates for MSEs might not be enough to achieve a major change in levels of formality in Peru. On similar lines, the World Bank (Perry *et al.*, 2007) stated that such a goal would also require improving the incentives for joining the formal sector, including improvements in private and public services available to formal firms (for example, technical assistance, access to credit and contract enforcement), and enhancing the level of enforcement – currently focused on formal businesses.

### 3. Challenges arising when implementing competition law in sectors where informality is high

16. In Peru, Legislative Decree No. 1034, the Law on Suppressing Anti-Competitive Practices (hereafter “the Law”), applies to all economic agents supplying or demanding goods or services regardless of whether they perform activities in the formal or informal sector of the economy. Indecopi is responsible for oversight of compliance with free market regulations by economic agents, whether informal or not, and for ensuring that markets operate efficiently. The Law also considers the effects of anti-competitive practices on competitors, whether informal or not, and consumers generally.

17. Over the past five years as part of its work scrutinising anti-competitive practices, the Commission<sup>26</sup> [*sic*] has reached decisions in proceedings in certain cases in which informal economic agents' participation formed part of the analysis. This posed challenges in respect of the proper application of the Law to the extent that the Commission had to bear in mind

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<sup>25</sup> According to the CCL (2017), “the informal economy (business and labour) reduces a country's medium-to-long-term growth potential”. LA CÁMARA (2017). *Op. cit.*, p. 9.

<sup>26</sup> The Commission refers to the “Comisión de Defensa de la Libre Competencia (CLC)”.

the implications for identifying the market under scrutiny, the development of an anti-competitive practice and the level of effective competition in the markets identified.

18. Where enforcement of the Law is concerned, in April 2018, Resolution 024-2018/CLC-INDECOPI fined five businesses a total of PEN 353,376.50 (USD 110,117.70) for agreeing the prices for a public passenger transport service between Cajamarca and Cajabamba, and vice versa, in the Cajamarca region between October 2014 and March 2015. Two of the five businesses did not hold a valid permit to supply the passenger transport service on the route in question while engaged in the anti-competitive practice.

19. Another instance, this time not an administrative procedure for breach of the Law but relating to identification of the relevant market and the conditions of competition therein, involved a request by the Supervisory Board for Investment in Public Transport Infrastructure (Ositran)<sup>27</sup> to analyse the conditions of competition in the supply of river port services in the city of Yurimaguas, Loreto. The case, dating back to 2015, was complex in two respects: first, it involved analysing the impact of the future entry into operation of the “Nueva Reforma”<sup>28</sup> port terminal, and, second, it took into consideration the operations performed by informal quays in the region in order to determine whether the river port services at Yurimaguas would be provided under conditions of effective competition.

20. In 2015, the city of Yurimaguas had two formal-sector public port facilities, although one of them was for the exclusive use of Peru’s oil company, Petroperú; it also had six informal-sector quays along the rivers Huallaga and Paranapura to take deliveries and load a wide range of shipments.<sup>29</sup> The informal nature of the port arrangements in Yurimaguas is in accordance with local people’s customary practices and is the result of the limited space and infrastructure at the only port in the area capable of servicing the demand from ships.

21. The parameters of the relevant market were defined for three types of port services: nautical services, cargo handling and passenger services. It was found that the informal quays, located close to the Peruvian National Ports Enterprise (Enapu),<sup>30</sup> also provided each of these services, albeit on a small scale and without adequate infrastructure or the necessary equipment, but their service provision was a far cry from that at a port. Additionally, two of the six informal quays operating in the area were more significant because of the type of motorboats and vessels they catered for, i.e. larger than 100 units of gross tonnage.<sup>31</sup>

<sup>27</sup> In accordance with Ositran’s General Tariff Regulations (RETA) and as part of Ositran’s tariff-setting procedure, Indecopi will give a ruling on the conditions of competition in the markets.

<sup>28</sup> On 31 May 2011, the Peruvian State and the consortium COPAM signed the Concession Contract for the design, construction, financing, maintenance and operation of Nueva Reforma, the new port terminal at Yurimaguas.

<sup>29</sup> The products and services supplied in the area include the transportation of general cargo, passengers, timber, scrap metal, animals, vehicles, beer, refrigerating equipment, motorbikes, motorised tricycles, oil exploration and drilling equipment, cabling and public lighting.

<sup>30</sup> Enapu port in Yurimaguas has been in service since the 1970s and was refurbished in 1998.

<sup>31</sup> The other quays deal only with very small boats and launches (*botes, lanchas, peque-peques*) generally delivering perishable products, fruit and live animals to market in the various parts of Yurimaguas city.

22. In view of this, the forthcoming entry into operation of Nueva Reforma would change the conditions of competition in the relevant market because, after the first phase of works,<sup>32</sup> the new port would be twice as big as the Enapu port.<sup>33</sup> Additionally, the improved levels of security in cargo transfer and the higher productivity anticipated when Nueva Reforma port starts operating mean that, in view of the infrastructure around them and their equipment, neither Enapu port nor the two informal quays receiving large vessels could effectively compete in terms of loading products such as vehicles, motorcycles, beverages, timber and household appliances that require proper handling.<sup>34</sup>

23. Therefore, to the extent that the entry into operation of Nueva Reforma port will alleviate congestion at the small-scale quays in Yurimaguas and will initiate the process of formalising local port activities in that area, and given that businesses and freight agents expressed interest in using the facilities, the conclusion was reached that the new port would operate in an environment of limited effective competition because Enapu port and the other quays would ultimately deal only with freight in bulk and passengers.<sup>35</sup>

#### 4. Indecopi's approach to tackling informality

24. With regard to the initiatives promoted by Indecopi to tackle informality, it is clear that, because of its size and diversity, Indecopi – the body responsible for defending and promoting free competition – essentially has limited tools with which to resolve this issue in the short term. However, the work produced by the institutions has drawn on three sources: legal issues – addressing red tape; educational aspects – campaigns encouraging formalisation and the consumption of original products; and economic incentives – the grant of collective trademarks to agricultural producers.

25. Indecopi was able to adopt these measures because of its structure: it combines the duties associated with the defence and promotion of free competition with powers in the fields of intellectual property protection, elimination of bureaucratic barriers, unfair competition, consumer protection and tendering procedures, as well as those relating to dumping, subsidies and the elimination of non-tariff barriers.

26. For example, the work done on the regulatory burden to identify and promote the elimination of unlawful and/or unreasonable bureaucratic barriers to starting a business (e.g. operating licences) in 2017 alone numbered 170 [*sic*] which, in economic terms, is estimated to represent a potential saving for entrepreneurs of PNS 41.6 million

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<sup>32</sup> The plan is to expand the port both physically and in terms of facilities once cargo traffic there exceeds 675,000 t annually.

<sup>33</sup> The area of Nueva Reforma port is three times larger than Enapu port and is closer to the Tarapoto-Yurimaguas road that connects two important trading cities.

<sup>34</sup> Both in terms of the goods that can be transported in bulk such as agricultural products or building materials, and in terms of passenger transport, there will continue to be competition between the ports and the informal quays.

<sup>35</sup> Additionally, in the medium term, when the Amazon waterway project (*Hidrovia*) is implemented, which will make it possible to dredge the jungle rivers, it will be possible for containerised freight vessels to begin to navigate them, and they could be serviced only by Nueva Reforma port given that neither Enapu nor the informal quays have the infrastructure or equipment to receive them.

(USD 12.6 million).<sup>36</sup> In terms of intellectual property protection, Indecopi has promoted initiatives through its Copyright Directorate to raise awareness of the negative effect of piracy and the importance of purchasing original products;<sup>37</sup> additionally, through its Distinctive Signs Directorate, it has promoted the Collective Trademarks Registration<sup>38</sup> service, free of charge for a period, in order to encourage take-up by Peru's farming communities. An electronic Gazette of Industrial Property was also developed to publish applications for trademarks and patents free of charge; previously, the procedure had to be carried out using the Peruvian Official Journal, and the savings generated in respect of 2017 are estimated at PNS 4.6 million (USD 1.4 million) for entrepreneurs and businesspeople.

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<sup>36</sup> Indecopi (2018). *Midiendo el ahorro económico de empresas y ciudadanos por la eliminación de barreras burocráticas en el Perú durante el 2017* [Measuring the economic savings for businesses and the public due to cuts in red tape in Peru in 2017]. Observatorio de Mercados – Year 12, No. 36, May 2018. Drafted by the Department of Economic Research at Indecopi. Available at: [https://www.indecopi.gob.pe/documents/20182/2375854/20180528\\_Observatorio\\_de\\_barreras\\_burocr%C3%A1ticas\\_2017.pdf/0dd47685-ea0d-11fd-462c-1db6ecbc2e6b](https://www.indecopi.gob.pe/documents/20182/2375854/20180528_Observatorio_de_barreras_burocr%C3%A1ticas_2017.pdf/0dd47685-ea0d-11fd-462c-1db6ecbc2e6b).

<sup>37</sup> Piracy levels in Peru's creative industries are high.

<sup>38</sup> A distinctive sign which distinguishes the geographical origin, material, mode of manufacture or other common characteristics of goods or services of different enterprises using the collective mark. From [www.wipo.int](http://www.wipo.int).