

## GLOBAL FORUM ON COMPETITION – 2013

### COMPETITION AND POVERTY REDUCTION Contribution from Peru

#### 1. Defining poverty and identifying its causes

There are several ways of measuring poverty. In Peru, the main indicator used by the government in the analysis and evaluation of economic and social policies is the percentage of people below the poverty line, which includes two components: the food component (also called extreme poverty line) and the non-food component.<sup>1</sup> Considering this approach, poverty in Peru has declined in the last few years, despite the context of international crisis. In fact, in the year 2011, total poverty in Peru was equal to 27,8%, while extreme poverty was 6,3% (see Table 1). The decrease in the poverty indicator meant that 800 thousand people are no longer in poverty and more than 360 thousand are no longer in extreme poverty.

**Table1. PERÚ: TOTAL AND EXTREME POVERTY**  
(% of population)

Area of residence	2009	2010	2011
<b>Total poverty</b>			
National	33,5	30,8	27,8
Rural	66,7	61,0	56,1
Urban	21,3	20,0	18,0
<b>Extreme poverty</b>			
National	9,5	7,6	6,3
Rural	29,8	23,8	20,5
Urban	2,0	1,9	1,4

Source: Ministry of Economics and Finance (2012). *Marco Macroeconómico Multianual 2013-2015*.

Different factors cause poverty in Peru. According to Verdera (2007), rural poverty is caused by the pattern of concentration in land tenure<sup>2</sup> and the low returns to land. On the other hand, urban poverty is caused by the low employment intensity in industries with increased production, the lack of demand for labour in relation to the strong growth in labour supply and the low productivity of workers in areas that generate more jobs (which is translated in lower wages).<sup>3</sup> Lack of competition is not directly identified as a source of poverty in Peru.

#### 2. Competition's effect on markets for essential items, in principle

From the point of view of standard microeconomic theory, competition is expected to promote allocative and productive efficiency in the markets for essential goods and services.

<sup>1</sup> It should be mentioned that the National Household Survey allows many other forms of measuring poverty, which are incorporated by other government bodies -such as the Ministry of Development and Social Inclusion- in their decision making processes.

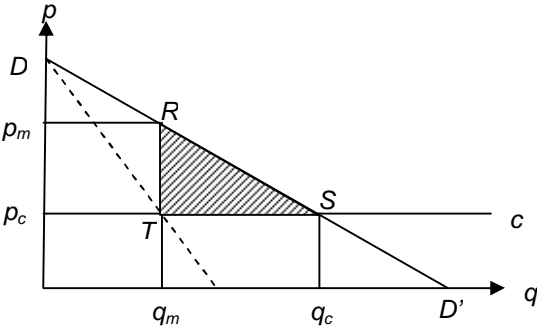
<sup>2</sup> According to the latest National Agricultural Census, 3,1% of farms (producers) accounted for 77,6% of the area under cultivation, while 70,3% of the units (producers) with size up to 4,9 ha, had only 5,8% of surface.

<sup>3</sup> Verdera, F. (2007). *La pobreza en el Perú: un análisis de sus causas y de las políticas para enfrentarla*. Lima, Instituto de Estudios Peruanos (Serie Análisis Económico, 24).

In order to illustrate this, assume for simplicity that there is a linear market demand represented by the line  $DD'$  in Graph 1, as well as constant marginal costs represent by line  $c$ . Under perfect competition, price equals marginal cost ( $p_c = c$ ) and the quantity sold to consumers is  $q_c$ . In this case, welfare (defined as the sum of consumer surplus and producer surplus) is given by the triangle  $Dp_cS$  (in this case, firms do not get any surplus, given that profits are equal to zero).

In a monopoly situation, price is set on  $p_m$  (higher than  $p_c$ ) and equilibrium quantity is given by  $q_m$  (lower than  $q_c$ ). Therefore, welfare is given by the area described by the points  $Dp_mTR$ , which includes producer surplus ( $p_m p_c TR$ ) and consumer surplus ( $Dp_mR$ ) and, as a result of the existence of a monopoly, a deadweight loss is generated (area of the triangle  $RTS$ )

**Graph 1. EQUILIBRIUM UNDER PERFECT COMPETITION AND MONOPOLY**

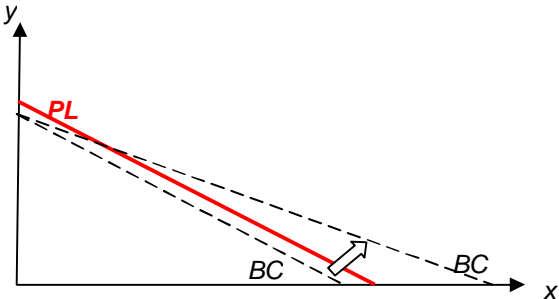


Assuming that we start from a monopoly situation, the introduction of competition will mean an increase in the quantity consumed (from  $q_m$  to  $q_c$ ) and a decrease in price (from  $p_c$  a  $p_m$ ). In other words, starting from a monopoly situation, more competition permits that people who previously could not access this essential good or service can now consume it.

Taking into account the methodology used to measure poverty which was described in Section 1, we can define poverty as consumers whose income is lower than a budget constraint (line  $PL$  in Graph 2). This is the case of a consumer with a budget constraint given by the dotted line  $BC_1$ .

As we mentioned before, the introduction of competition in a market generates a decrease in price level. This means a change in the price relation  $P_y/P_x$ , that is, the slope of the budget constraint changes (this is illustrated by the change from  $BC_1$  to  $BC_2$  in Graph 2). As a consequence, consumption possibilities are increased and people who used to be below the poverty line are now above it and poverty is decreased.

**Graph 2. EFFECTS OF THE INTRODUCTION OF COMPETITION**



### 3. Competition's effect on markets for essential items, in reality

In the last few years, Indecopi has acquired important experience introducing competition in several markets for essential goods such as chicken, sugar, milk, medicinal oxygen, cement and medicines; as well as in markets for essential services such as automobile insurance, notary services and public transportation.

- In the chicken case (1996), the Defense of Free Competition Commission (CLC) and the Tribunal of Indecopi sanctioned the firms of a poultry association for colluding to fix prices and limit the production of chicken, an important component of the Peruvian basket of consumer goods and services.<sup>4</sup>
- In the sugar case (2006), an ex officio investigation was initiated due to the presence of indications of a possible agreement for the fixation of the price and the production of sugar. However, it was found that the supply conditions were determined by external factors, and not by the behaviour of the firms under investigation.<sup>5</sup>
- In the milk case (2007), an association of dairy farmers filed a complaint against a firm with a dominant position in the production of evaporated milk because of the imposition of excessively low prices. Nonetheless, given that the nature of the practice could not affect competition (and could potentially reduce the price of milk products) the claim was found inadmissible.<sup>6</sup>
- In the medicinal oxygen case (2008), CLC sanctioned the firms that provided medicinal oxygen to EsSalud (a state owned social insurance and medical provider), a product which demand is inelastic because it is essential for the preservation of life and health of people who cannot afford private medical facilities. CLC was determined that between the years 1999 and 2004 the providers of medicinal oxygen divided geographically their tenders for the acquisition of this item by EsSalud.<sup>7</sup>
- It should be mentioned that in 2010 two cases were initiated and are still under investigation. The first one is about the possible establishment of a vertical scheme to boycott a new entrant into the Peruvian cement market, which is highly concentrated and geographically distributed.<sup>8</sup> The second one is a sanctioning procedure against several pharmacy chains for allegedly fixing the prices of some medicines and supplements.<sup>9</sup>
- Regarding essential services, in 2004 CLC sanctioned the firms which offered automobile insurance nationwide because they fixed the amount charged for premiums and minimum insurance deductibles between the years 1999 and 2003.<sup>10</sup>

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<sup>4</sup> Resolution 276-97-TDC, 19 November, 1997. Available in:  
<http://aplicaciones.indecopi.gob.pe/ArchivosPortal/articulos/2005/3/1-66/Re276-1997.pdf>

<sup>5</sup> Resolution 029-2009/CLC-INDECOPI, 7 May 2009. Available in:  
<http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES029-2009/Res029-2009.pdf>

<sup>6</sup> Resolution 005-2010/ST-CLC-INDECOPI, 15 April 2010. Available in:  
[http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES\\_005\\_2010\\_ST\\_CLC/Res005-2010ST.pdf](http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES_005_2010_ST_CLC/Res005-2010ST.pdf)

<sup>7</sup> Resolution 051-2010/CLC-INDECOPI, 13 August 2010. Available in:  
[http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES\\_051\\_2010\\_CLC/Res051-2010.pdf](http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES_051_2010_CLC/Res051-2010.pdf)

<sup>8</sup> The brief note of the beginning of this procedure is available in:  
[http://www.indecopi.gob.pe/repositorioaps/0/2/jer/notas\\_interes\\_clc/NotasInicioProc/Res-004-2010-ST-CLC-INDECOPI.pdf](http://www.indecopi.gob.pe/repositorioaps/0/2/jer/notas_interes_clc/NotasInicioProc/Res-004-2010-ST-CLC-INDECOPI.pdf)

<sup>9</sup> The brief note of the beginning of this procedure is available in:  
[http://www.indecopi.gob.pe/repositorioaps/0/2/jer/notas\\_interes\\_clc/NotasInicioProc/Nota017-2010-ST-CLC-INDECOPI.pdf](http://www.indecopi.gob.pe/repositorioaps/0/2/jer/notas_interes_clc/NotasInicioProc/Nota017-2010-ST-CLC-INDECOPI.pdf)

<sup>10</sup> Resolution 009-2008/CLC-INDECOPI, 25 February 2008. Available in:  
<http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES009-2008/Res009-2008.pdf>

- There have also been several cases regarding transportation services in different areas. In these cases, associations and groups of carriers (cargo and passenger) allegedly decided and imposed tariffs to users. Some of these cases are still under investigation.<sup>11</sup>
- Finally, in the notary services case (2011), a procedure was initiated against a notary association for allegedly fixing prices and conditions of notary services related to security interests normally used in small loans.<sup>12</sup>

Unfortunately, we do not have any study about the real impact of these decisions on poor consumers.

#### 4. Competitive markets versus “pro-poor” government controls/interventions

There is usually pressure on the government to directly intervene on markets through the provision of goods and services, either through public firms or establishing subsidies to the demand or supply. These claims for a greater intervention of the State in the economy are risky if they are not adequately focused, given that they can exclude private competitors from the market.

The Peruvian Political Constitution of 1993 limits the intervention of the State in the economy through a public firm which directly provides goods or services. This kind of activities is allowed but conditioned to the fulfilment of three requirements: (i) the State intervention must be authorized by means of a special law; (ii) the activity must be “subsidiary”<sup>13</sup> and (iii) there must be an overriding “public interest” or “manifest national benefit” supporting the State intervention.<sup>14</sup> It should be mentioned that, according to article 14.3 of Legislative Decree 1044<sup>15</sup>, the Overseeing of Unfair Competition Commission of Indecopi is in charge of analyzing the subsidiary role of public firms.

To date, several of these cases have been analyzed by Indecopi. Some of the most important cases are the allegations made against the services provided by two hospitals and

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<sup>11</sup> Information about some of these cases can be found in:

- Resolution 085-2009/CLC-INDECOPI, 22 December 2009. Available in: [http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES\\_085\\_2009\\_CLC/Res085-2009.pdf](http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES_085_2009_CLC/Res085-2009.pdf)
- Resolution 069-2010/CLC-INDECOPI, 6 October 2010. Available in: [http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES\\_069\\_2010\\_CLC/Res069-2010.pdf](http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES_069_2010_CLC/Res069-2010.pdf)
- Resolution 055-2011/CLC-INDECOPI, 11 October 2011. Available in: [http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES\\_055\\_2011\\_CLC/Res055-2011CLC.pdf](http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES_055_2011_CLC/Res055-2011CLC.pdf)
- Resolution 056-2011/CLC-INDECOPI, 11 October 2011. Available in: [http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES\\_056\\_2011\\_CLC/Res056-2011CLC.pdf](http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES_056_2011_CLC/Res056-2011CLC.pdf)

<sup>12</sup> Procedure initiated by Resolution 019-2011/ST-CLC-INDECOPI, 27 December 2011.

<sup>13</sup> The “subsidiarity” principle means that the State can participate in the provision of goods or services as long as there is no supply from the private sector capable of satisfying the demand for those goods or services; or that, even in the presence of private firms supplying those goods or services, there are segments of the population which are not met by the private supply because of their characteristics and conditions. In other words, the State should not replace private firms in the provision of goods or services.

<sup>14</sup> “**Artículo 60º.**- El Estado reconoce el pluralismo económico. La economía nacional se sustenta en la coexistencia de diversas formas de propiedad y de empresa. Sólo autorizado por ley expresa, el Estado puede realizar subsidiariamente actividad empresarial, directa o indirecta, por razón de alto interés público o de manifiesta conveniencia nacional. La actividad empresarial, pública o no pública, recibe el mismo tratamiento legal.”

<sup>15</sup> Legislative Decree which approves the Repression of Unfair Competition Act, given on 25 July 2008.

four specialized institutes of the Ministry of Health under differential tariffs<sup>16</sup>. In the cases of the two hospitals, Indecopi determined that the services provided under differential tariffs were not expressly authorized by law<sup>17</sup>, while the cases of the four institutes are still under investigation.

## **5. Competition's effect on poor, small entrepreneurs and job seekers, in principle**

From a standard economic theory perspective, competition promotes efficiency, driving markets towards the equilibrium of supply and demand and making prices equal to marginal costs. This way, a signal is given to markets so that allocative and productive efficiency are achieved. In other words, the introduction of competition pursues the maximization of economic welfare.

The effect of the introduction of competition on poor, small entrepreneurs and job seekers is not clear, at least not in the short run. For instance, it may protect them from the abuse of a dominant firm and could also eliminate the harm produced by corruption and inefficient practices like nepotism and other forms of favouritism associated with practices such as bid rigging.

Another way in which competition may benefit job seekers and poor entrepreneurs to earn more is through the increase in productivity. In fact, in the presence of more competition, there is pressure on job seekers and poor entrepreneurs to become more productive, either through the accumulation of knowledge and abilities or through the improvement in productive processes, which in the end should benefit job seekers and poor entrepreneurs through higher wages and higher benefits, respectively.

However, competition may also harm small entrepreneurs by driving them out of the market because of the reduction of market prices. Nonetheless, as stated in Motta (2004)<sup>18</sup>, if small entrepreneurs are not operating in an efficient scale of production, artificially protecting them is in contrast with economic welfare objectives since it would encourage inefficient allocation of resources and it would contribute to keep high prices in the economy.

## **6. Competition's effect on poor, small entrepreneurs and job seekers, in reality**

To date, we do not have any study about a case handled in the competition agency in which greater competition clearly affected poor, small entrepreneurs or poor job seekers/wage earners.

In order to ensure that the benefits of competition "trickle down" to the poor, competition authorities should focus on making sure that there are no structural, legal or behavioural barriers that may prevent small entrepreneurs to enter the market. This can be done through their usual work of enforcement of competition laws, as well as using advocacy to create a culture of competition. This includes, for example, the identification of existing or proposed

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<sup>16</sup> The services provided under differential tariffs are the ones provided by the hospital or specialized institute for a higher price in exchange for receiving a service with special characteristics such as lower waiting time, private rooms, etc.

<sup>17</sup> See Resolutions 2549-2010/SC1-INDECOPI and 2550-2010/SC1-INDECOPI, 14 September 2010. Available in: [http://sistemas.indecopi.gob.pe/sdc\\_Jurisprudencia/documentos/1-93/2010/Re2549.pdf](http://sistemas.indecopi.gob.pe/sdc_Jurisprudencia/documentos/1-93/2010/Re2549.pdf) and [http://sistemas.indecopi.gob.pe/sdc\\_Jurisprudencia/documentos/1-93/2010/Re2550.pdf](http://sistemas.indecopi.gob.pe/sdc_Jurisprudencia/documentos/1-93/2010/Re2550.pdf), respectively.

<sup>18</sup> Motta, M. (2004). *Competition policy: theory and practice*. Cambridge University Press. P. 22.

laws and/or government programmes which may unduly restrict competition. Furthermore, competition authorities must advocate for the strengthening of courts, the promotion of transparency and the elimination of corruption in the government.

To this respect, it should be mentioned that Indecopi, through its elimination of Bureaucratic Barriers Commission, identifies and eliminates rules and regulations of Public Administration entities which constitute bureaucratic barriers that irrationally limit or restrict access or permanence of economic agents in the market and contributes to simplify the administrative process through a subsequent control of rules and regulations. Mínguez (2011) found that the elimination of bureaucratic barriers during the year 2010 meant a benefit of 0,004% of the Peruvian GDP.<sup>19</sup>

## **7. Competition policy toward poverty**

Competition policy toward the poor should not be different than it is toward the rest of society. We believe that competition policy contributes to solving problems of access of poor consumers to essential goods and services, but it does not appear to be enough. Therefore, governments should use other policies to combat poverty.

The prioritization of ex officio interventions has been carried out on the basis of the presence of evidences of the existence of anticompetitive practices and taking into account if the good or service in question is essential or not. Thus, even though the potential effects on poverty are not explicitly incorporated in determining the areas to be investigated, ex officio investigations are performed mainly in markets of essential goods or services.

Finally, we believe that most of the enforcement activities should be focused in big trusts of national presence; while in the case of small, highly localized monopolies we should use more competition advocacy, in particular, looking forward to identifying the reasons behind their formation and removing the possible barriers to entry into these markets.

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<sup>19</sup> Mínguez, R. (2011). *Estudio de medición del impacto de las barreras burocráticas en el mercado. Informe final*. Available in: <http://www.indecopi.gob.pe/repositorioaps/0/3/par/estudio/estudioimpactobarrerasmercado.pdf>