

**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 the United States -

18-19 September 2018, Buenos Aires, Argentina

The attached document from the United States 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.

Ms. Iratxe Gurpegui, Competition Expert, - Iratxe.GURPEGUI@oecd.org.

Ms. Lynn Robertson, Manager GFC, LACCF ; Competition Expert - Lynn.Robertson@oecd.org.

JT03435236

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

Competition Policy and the Informal Economy

- Contribution from the United States -

1. The influence of the informal economy is not as prevalent in the United States as it is in some economies.¹ While there are many reasons for this, one of the most significant is that the regulatory cost of doing business in most markets in the United States is sufficiently low that entrepreneurs do not feel a need to retreat to the informal economy in order to avoid those costs.² While the informal economy thus has a minimal impact on the antitrust agencies' direct enforcement responsibilities, the need to ensure that the regulatory cost of doing business remains at a level that encourages firms to remain within the formal economy suggests a critical role for competition advocacy to promote regulatory approaches that impose the least onerous barriers to participating in the formal economy.

1. The Informal Economy and Enforcement

2. The United States antitrust agencies, the Department of Justice and the Federal Trade Commission, do not directly attempt to address the causes and effects of the informal economy. To be sure, the failure of firms in the informal economy to abide by the rules can affect their role in the market, to the extent that firms that do not comply with regulations likely incur fewer costs than firms that comply with regulatory requirements. Nonetheless, these problems are more effectively addressed by specialized regulators who have particular expertise and appropriate enforcement tools.

3. In cases in which informal market participants play a role in an antitrust market under investigation, the role of those market participants is taken into account just as formal participants are. Their market shares would be estimated according to the best available data and their ability to constrain an anticompetitive rise in prices or decrease in output would be considered. Consideration of their ability to constrain prices would, of course, need to take into account any limitations on their competitive significance that is caused by the informal nature of their market participation, the likelihood of market exit that might be caused by law enforcement efforts, and the extent to which price discrimination is

¹ According to a World Bank study, the shadow economy amounted to only 8.4% of the U.S. economy in 2007, compared to a global average of 28.4%. F. Schneider et al, Shadow Economies All Over the World, Policy Research Working Paper 5356, available at <http://documents.worldbank.org/curated/en/311991468037132740/pdf/WPS5356.pdf>.

² According to the World Bank, it takes six days to form a business in the United States, as opposed to 31.7 days in the Latin America and the Caribbean region; 81 days to deal with construction permits as opposed to 191.8 days; and 15 days to register real property, as opposed to 111.6 days. World Bank, Doing Business Project (2018), available at <http://www.doingbusiness.org/>.

feasible against an infra-marginal group of purchasers who insist on lawful products and who qualify as a distinct market.

2. Removal of Incentives to Participate in the Informal Economy

4. Identifying the most appropriate role for a competition agency in addressing market distortions caused by the informal economy requires asking why firms operate in the shadows rather than as part of the formal economy. While there are many reasons, one documented cause is that burdensome regulation can make it difficult for entrepreneurs to enter the formal market and thus drive them underground.³ As Hernando De Soto notes:

“in Peru, for example, it takes a new entrepreneur thirteen years to overcome the legal and administrative hurdles required to build a retail market for food that would help take vendors off the street; twenty-one years to obtain authorisation to construct a legally titled building on wasteland; twenty-six months to get authorisation to operate a new bus route; and nearly a year, working six hours a day, to gain the legal license to operate a sewing machine for commercial purposes.

5. In the face of such obstacles, new entrepreneurs hold their assets outside the law and therefore do not have access to the facilitative devices that a formal legal system should provide to help them organise and leverage resources. Because they have no secure property rights and cannot issue shares, they cannot capture investment. Because they have no patents or royalties, they cannot encourage or protect innovations. Because they do not have access to contracts and justice organised on a wide scale, they cannot develop long-term projects. Because they cannot legally burden their assets, they are unable to use their homes and businesses to guarantee credit.”⁴

6. Establishing regulations that impede the productivity of formal firms promotes a systemic misallocation of resources by creating incentives for firms to remain informal.⁵ Not only can regulations misallocate resources by harming the productivity of formal firms, they can serve as barriers to entry keeping out firms or workers that hope to enter the formal sector. These barriers impede the Schumpeterian creative destruction of the unproductive

³ William E. Kovacic, *Designing and Implementing Competition and Consumer Protection Reforms in Transitional Economies: Perspectives from Mongolia, Nepal, Ukraine, and Zimbabwe*, 44 DePaul L. Rev. 1197, 1206-08 (1994).

⁴ Hernando De Soto, *The Other Path, The Economic Answer to Terrorism* (2002) xviii-xix. Access to credit is overwhelmingly seen as the biggest barrier to growth by both informal firms and small formal firms. See R. La Porta & A. Shleifer, *Informality and Development*, 28 *J. of Economic Perspectives* 109, 116 (2014). The academic literature does raise questions as to whether, even in the absence of burdensome regulation, informal enterprises are likely to transition to the formal sector given the relatively low educational levels of managers of informal firms. R. La Porta & A. Shleifer, *Informality and Development*, 28 *J. of Economic Perspectives* 109, 117 (2014). Even if not, however, employees in the informal sector are strong candidates for transition to the formal sector. *Id.*

⁵ Matías Busso, María Victoria Fazio, and Santiago Levy, “(In)formal and (Un)productive: The Productivity Costs of Excessive Informality in Mexico,” Inter-American Development Bank, IDB Working Paper Series No. IDB-WP-341, 2012, at 32.

economy.⁶ In principle, therefore, a strategy of minimizing occupational barriers to entry and growth can help accelerate the growth of the formal sector and reduce the footprint of the informal economy.

7. While regulation clearly has an important role in protecting consumers' health, safety, and well-being, it has the potential to introduce barriers to formal participation in markets that may create incentives for firms to remain in the informal sector. A valuable role that a competition agency can play is to encourage regulators and lawmakers to balance the costs and benefits of regulation. This has been an important part of the DOJ and FTC competition policy toolkit for many years.⁷ Without an informed balance of costs and benefits, it can be difficult to understand the hidden effects of regulation and to recognize when those costs outweigh the desired benefits. Indeed, there are many cases where proponents of regulation assert some public benefit when the real purpose and effect of the proposed regulation is to restrict or eliminate competition.

8. Through its competition advocacy functions, a competition agency can bring great value by helping to illuminate the difference between the legitimate purposes of regulation and attempts to use regulation to hinder competition. A competition agency can also help regulators identify less restrictive ways to address legitimate regulatory goals. Restrictive business regulation is often promoted by those who have an economic stake in restricting entry into markets, normally vested incumbents.⁸ Regulations that are not carefully tailored to their legitimate purposes can slow down the vital process of creative destruction by protecting a sector's less productive incumbent firms at the expense of innovative challenger firms.

9. More broadly, competition agencies may be among those within government who institutionally appreciate the importance of applying a cost-benefit analysis to regulation. They may thus be well-positioned to assist legislators and regulators to develop an approach to regulation informed by an understanding of how their actions can create or reduce incentives for participation in the formal economy. In some cases, the competition agency may be the only government institution with the expertise, interest, and resources

⁶ Schumpeterian creative destruction is the incessant revolution of the economy from within caused by innovation. See Joseph A. Schumpeter, "Capitalism, Socialism and Democracy," Harper, New York (3d ed. 1950), at 81-86.

⁷ See Mainstreaming Competition Policy Into the Overall Economic Policy and Government Actions in Latin America and the Caribbean – Contribution from the United States (Latin American Competition Forum, September 2014), available at https://www.ftc.gov/system/files/attachments/us-submissions-oecd-other-international-competition-fora/mainstreaming_competition_policy_us_oecd.pdf. More broadly, the Office of Information and Regulatory Affairs in the Office of Management and Budget has responsibility for balancing costs and benefits of federal regulation generally. See <https://www.whitehouse.gov/omb/information-regulatory-affairs/>.

⁸ See, e.g., FTC Commissioner Maureen K. Ohlhausen, "Brother, May I?: The Challenge of Competitor Control over Market Entry," Remarks before The Global Antitrust Economics Conference (May 29, 2015), available at https://www.ftc.gov/system/files/documents/public_statements/645861/150529gmukeynote.pdf.

to balance the costs and benefits of regulation and to advocate publicly for the removal of regulations that prevent market entry.⁹

3. Occupational Licensure as a Barrier to Participation in the Formal Economy

10. In 2017, the Federal Trade Commission established an “Economic Liberty Task Force” to examine occupational restrictions that restricted the opportunity of individuals to practice. According to former Acting Chairman Maureen Ohlhausen, individuals on the lower and middle rungs of the economic ladder are disproportionately affected by occupational licensing. “Occupational licensing regulations can prevent individuals from using their vocational skills and entering new professions, as well as starting small businesses or creating new business models.”¹⁰

11. The FTC has been studying the effects of excessive occupational licensing for many years. In a seminal 1990 study, for example, FTC economists Carolyn Cox and Susan Foster found that “occupational licensing frequently increases prices and imposes substantial costs on consumers. At the same time, many occupational licensing restrictions do not appear to realize the goal of increasing the quality of professionals' services.”¹¹

12. Over the years, the FTC has used its competition advocacy tools to argue against excessive regulation that has the potential of excluding individuals from the formal economy. While these interventions were aimed at increasing competition and were not specifically aimed at moving resources from the informal sector to the formal one, the effect may have been the same. Occupational restrictions are most likely to impact participation in the formal economy in sectors that require little capital, use relatively simple production and marketing methods and employ less skilled workers.¹² These are also the sectors in which formal firms face the most direct competition from informal firms.¹³ A few examples follow.

⁹ See Mainstreaming Competition Policy Into the Overall Economic Policy and Government Actions in Latin America and the Caribbean – Contribution from the United States (Latin American Competition Forum, September 2014), available at https://www.ftc.gov/system/files/attachments/us-submissions-oecd-other-international-competition-fora/mainstreaming_competition_policy_us_oecd.pdf.

¹⁰ FTC Acting Chairman Maureen K. Ohlhausen, “Advancing Economic Liberty,” Remarks at the George Mason Law Review’s 20th Annual Antitrust Symposium, February 23, 2017, available at https://www.ftc.gov/system/files/documents/public_statements/1098513/ohlhausen_-_advancing_economic_liberty_2-23-17.pdf.

¹¹ Cox and Foster (1990), The Costs and Benefits of Occupational Regulation,” available at https://www.ftc.gov/system/files/documents/reports/costs-benefits-occupational-regulation/cox_foster_-_occupational_licensing.pdf.

¹² Several states in the United States, for example, license hair braiders, requiring as many as 600 hours of training before qualifying as hair braiders. See Paul Avelar & Nick Sibilla, Untangling Regulations (2014), available at <https://ij.org/wp-content/uploads/2015/03/untangling-regulations.pdf>.

¹³ Gonzalez and Francesca Lamanna, “Who Fears Competition from Informal Firms? Evidence from Latin America,” The World Bank, Policy Research Working Paper 4316, at 17.

3.1. Urban Transportation

13. Our first examples center on the taxi industry in the age of ride-sharing apps. In the United States, taxi services are regulated at the state or local level. In many jurisdictions, such as New York City, where entry is highly regulated, a substantial informal taxi industry, known as “gypsy” cabs developed alongside the formal industry.¹⁴ While the FTC had encouraged and witnessed some state and local deregulation of the industry prior to the introduction of ride-sharing apps,¹⁵ the arrival of new competition spurred a wave of regulation concerning the recent entrants.

14. For example, the City of Chicago proposed an ordinance regulating transportation network providers (TNPs). Among other provisions, the ordinance would have required an annual \$25,000 license fee and required \$1,000,000 in liability insurance for TNPs, compared to only an annual \$500 license fee and \$350,000 in insurance for traditional taxi services. The ordinance would also have prohibited TNP drivers from picking up or dropping off at the city’s airports.

15. The FTC submitted comments to the City Council of Chicago about the proposed ordinance.¹⁶ The comment warned that regulations should not “in purpose or effect favor one group of competitors over another,” and recommended that any necessary licensing fees should be structured as to avoid deterring new entry or further expansion into the market. The ordinance had few positive consumer protection benefits, and unnecessarily burdened TNPs. Ultimately, the FTC warned that many of the proposed regulations were not needed to meet the purported consumer protection purposes of the ordinance, and that the harm to competition outweighed any consumer protection benefits.

3.2. Teeth Floating

16. Animal teeth floating is the practice of filing down the outer contours of animal teeth, a common practice for horses. The practice is a routine topical service. Animal health services are regulated in the United States by state veterinary boards, which may typically define which services must be done by licensed veterinary personnel and do not require licensure. In Texas, as in many states, teeth floating is not considered a dental procedure that requires licensure. In 2010, however, the Texas Board of Veterinary Medical Examiners proposed a rule that would have expanded the definition of veterinary dentistry to include teeth floating, which would require a practitioner to have a veterinary license or

¹⁴ M. Frankena & P. Pautler, An Economic Analysis of Taxicab Regulation (1984), Federal Trade Commission Bureau of Economics Staff Report at 63 (1984), available at <https://www.ftc.gov/sites/default/files/documents/reports/economic-analysis-taxicab-regulation/233832.pdf>.

¹⁵ See Taxi Services Regulation and Competition – United States (submission to OECD Working Party No. 2 on Competition and Regulation, Oct. 2007), available at <https://www.ftc.gov/sites/default/files/attachments/us-submissions-oecd-and-other-international-competition-fora/ustaxis.pdf>.

¹⁶ Comment of the FTC Staff to Chicago City Council on Proposed Regulation of Transportation Network Providers (2014), available at https://www.ftc.gov/system/files/documents/advocacy_documents/ftc-staff-comment-honorable-brendan-reilly-concerning-chicago-proposed-ordinance-o2014-1367/140421chicagoridesharing.pdf.

be supervised by a licensed veterinarian. Research showed that most veterinarians did not normally perform teeth floating. This rule would create a shortage of personnel available to perform this service and would have raised prices.

17. In response, FTC staff submitted a comment concluding that the rule was likely to reduce competition and raise prices.¹⁷ The FTC noted that Texas horse owners would likely experience higher prices for horse floating services, with no apparent countervailing benefit to consumer protection. Lay horse teeth floaters, which include equine dentists, have been shown to be skilled at the practice and may be more skilled at the practice than a licensed veterinarian. The FTC concluded that the proposed rule would significantly restrict competition, and, without a better showing of the consumer protection benefits this rule provides, it should be rejected.

3.3. Interior Design

18. The interior design industry is generally not subject to government licensure, but practitioners may choose to seek accreditation by one of a number of private licensing boards. Accreditation may provide consumers with valuable information on a designer's quality, experience and other information, but generally, any individual may hold him or herself out as an interior designer without accreditation. In 1989, a law was proposed in Texas that would have created a State Board of Interior Design to license interior designers.¹⁸ Under the law proposed at the time, six years of professional education and completion of a state provided examination would be required to obtain a license. While the proposed law would not have prohibited unlicensed persons from practicing interior design, it would have prohibited use of the title "interior designer" by an unlicensed person.

19. The FTC submitted comments to the Texas Senate recommending disapproval of the proposed law, arguing that the law had little benefits to consumers, as multiple private accreditation boards already existed.¹⁹ The FTC commented that the law would harm competition and push out lower-priced designers, and as submitted, the law would do more harm than good.

20. In each of these cases, the proposed regulations are examples of the kind of regulatory intervention that could push non-licensed practitioners into the informal economy. When prices are artificially raised due to regulation in an industry, there is a greater risk of informal market participation.²⁰

¹⁷ Comment of the FTC Staff to the Texas Board of Veterinary Medical Examiners on Proposed Rule Restricting Competition (2010), available at <https://www.ftc.gov/os/2010/09/100910texasteethfloating.pdf>.

¹⁸ Comment of the FTC Staff to Texas Senator O.H. Harris on the Interior Designers Licensing Act (1989), available at https://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-staff-comment-hon.o.h.harris-concerning-texas-s.b.454-license-interior-designers/v890045.pdf.

¹⁹ Comment of the FTC Staff to Texas Senator O.H. Harris on the Interior Designers Licensing Act (1989), available at https://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-staff-comment-hon.o.h.harris-concerning-texas-s.b.454-license-interior-designers/v890045.pdf.

²⁰ See Gonzalez and Francesca Lamanna, "Who Fears Competition from Informal Firms? Evidence from Latin America," The World Bank, Policy Research Working Paper 4316, at 18.

4. Conclusion

21. The United States' experience has shown that removal of burdensome regulation can open the way to new entry into a variety of sectors of the economy and help to eliminate disincentives from participating in the formal economy.²¹ It also highlights how a competition agency can help legislators and regulators to understand the importance of balancing the costs – including the possible expansion of the informal sector – against the benefits of regulation. Due consideration must be given to the legitimate ends of regulation, while putting them into context and balancing them against how they impact entry.

²¹ It would go too far to suggest that the underground economy does not exist in the United States. Even after the repeal of prohibition, a significant traffic in illegal alcohol persisted, especially in mountainous southern regions, and response to the pervasive state regulation that replaced prohibition. Passengers arriving in American airports are familiar with promoters of unlicensed taxis that frequent the arrivals areas.