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Industrial Policy and the Promotion of Domestic Industry**

– Contribution from Peru –

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Session III: Industrial Policy and the Promotion of Domestic Industry

Industrial Policy and the Promotion of Domestic Industry: Aspects Related to Competition Policy¹

– Contribution from Peru –

1. Introduction

1. This contribution aims to present a very broad outline of, first, some of the general aspects of industrial policy in Peru, and, second, the current structure of government business activity and its implications for competition.
2. Industrial policy is geared to the private sector, so any impact on competition is likely to be found in the suppression of anti-competitive practices as set out in Legislative Decree 1034. In relation to government business activity, the impact of business practices falls within the scope of state activity, and the rules that apply are those suppressing unfair competition as set out in Legislative Decree 1044.
3. In order to ensure that we focus on the aspects most closely related to Indecopi's work, other related policies are not discussed in this contribution. However, we do not preclude the possibility that other policies that are not the subject of this paper may, in future, attract Indecopi's attention.

2. Overview of current industrial policy – contrast with the past

4. Until 2014, Peru's modern industrial policy, interpreted as meaning specific plans, programmes, projects and actions to encourage industrialisation, essentially focused on promoting small and micro businesses. The aim of programmes such as the Fondo MIPYME [Fund for Micro-, Small and Medium-sized Enterprises] or the Technology Innovation Centres (CITE) network at the Technology School of Peru (ITP) was – and is – to boost the productive development of micro, small and medium-sized enterprises.
5. The MIPYME Fund provides finance on advantageous terms to micro, small and medium-sized enterprises while the CITE provides training and support when introducing technical changes that aim to improve the productivity of small units of production or groups of small producers.²

¹ This document was drafted by Javier Coronado, General Manager of the National Institute for the Defence of Competition and the Protection of Intellectual Property (Indecopi), with comments from Abelardo Aramayo, the Technical Secretary at Indecopi's Unfair Competition Audit Commission (CCD), and Jorge Trelles, the Manager of Indecopi's Department of Economic Research. It does not necessarily represent the opinion of the multi-member bodies that make up the various decision-making bodies of Indecopi.

² The programme concerns the take-up of technology to develop basic processing of raw materials.

6. Since 2014, industrial policy has included a coherent structure for the various government initiatives, which is part of the **National Production Diversification Plan (PNDP)** promoted by the Ministry of Production (Produce).

7. The PNDP was approved on 28 July 2014 under Supreme Decree No. 004-2014-PRODUCE, and its principal aim is “to stimulate medium- and long-term growth by generating greater production and processing capacity, leading to economic diversification and sophistication, lower dependence on the prices of raw materials, increased productivity, a rise in formal, high-quality employment, and economic growth that is sustainable in the long term”.

8. It also set the following specific objectives:

- “To achieve high rates of economic growth that are sustainable in the long term.
- To emphasise the huge changes in production needed in order to move towards upper-middle incomes and reduce the Peruvian economy’s dependence on natural resources.
- To close regional productivity gaps.
- To increase formal, high-quality employment while reducing informality.”

9. This policy is clearly different from those of the 1970s and 1980s. Under these earlier policies, government business activity played a significant role (especially in relation to public services): there were high tariffs on the importation of final manufactured goods, and low tariffs on the importation of inputs or equipment, boosting certain sectors; there were special exchange-rate regimes for the import and export of goods; and sectoral state-owned financial entities such as the Industrial Bank of Peru were established.

10. The policies of that era can be regarded as “import-substitution industrialisation” (ISI),³ which was common in Latin America in the decades following the end of the Second World War.

11. A significant share of the State’s production apparatus and the state-owned financial entities that supported it were privatised or wound up under the structural reforms of the 1990s. For example, the Industrial Bank of Peru referred to above was wound up in a process that ended in 2010.⁴

12. It is generally thought that ISI significantly distorted the domestic markets, giving rise to inefficient production, corruption and profit-seeking practices that ultimately led to declining competitiveness and a downturn in industrial productivity.

³ This interesting essay discusses the performance of the Peruvian economy and refers to ISI: Jimenez, F. *et al.* (1998), “EL DESEMPEÑO DE LA INDUSTRIA PERUANA 1950-1995: DEL PROTECCIONISMO A LA RESTAURACION LIBERAL” [The performance of Peruvian industry 1950-1955: from protectionism to the return of liberal policy], DDD 142, CISEPA-PUCP. Viewed at: <http://files.pucp.edu.pe/departamento/economia/DDD142.pdf>.

⁴ Winding up finalised under Supreme Resolution No. 059-2010-EF.

3. Approach to the impact of industrial policy on competition

13. The PNPD focuses on three key priorities summarised in Table 1 below:

Table 1. PRIORITIES OF THE PRODUCTION DIVERSIFICATION PLAN

Strategic priority	Thematic focus of public intervention
Priority 1: Promotion of production diversification	The first priority of the PNPD is to promote business diversification and sophistication processes. Its action lines are: (i) strategies for integration into global value chains; (ii) attracting foreign direct investment; (iii) the development of innovative entrepreneurship; and (iv) incorporating innovation into strategy.
Priority 2: Changes to regulations and simpler administration	The second priority of the PNPD is to reduce the State's shortcomings in the area of business regulation. Its action lines are: (i) amendments to regulations; and (ii) simpler administration.
Priority 3: Greater productivity	The third priority concerns raising productivity. Its action lines are: (i) the extension of knowledge and technology; (ii) the promotion of synergies and production linkages; and (iii) the supply of complementary inputs.

Source: PNPD

14. In brief, both the PNPD and the specific actions, programmes and projects it encompasses have two key features.

- First, they are various forms of interventions aimed at micro and small businesses to increase their efficiency and productivity.
- Second, the actions involved do not lay down measures to boost specific industries; however, they do neatly marry up with the geography of the logistical channels nationwide, with a view to expanding the country's exports.

15. In terms of macroeconomics, the PNPD, in our view, is a good fit for a small economy that is open to international trade, and it also recognises the strategic importance of reducing the country's dependence on the export of raw materials.

16. To that end, the PNPD has not, to any significant extent, attracted the attention of the competition agency in matters concerning state aid, structural market changes that could give rise to dominant positions, thus raising concerns around competition, or rules, regulations or exemptions that may trigger market surveys or competition advocacy.

17. However, the absence of a link to industrial policy has not precluded investigations into actions by the State to promote the development of a service.

18. For example, together with the Bureau of Economic Research (GEE), the Free Competition Commission (CLC)⁵ recently opened a market survey on the market in the issuance and distribution of vehicle number plates.⁶ The survey notes that, when

⁵ See the press release at: https://www.indecopi.gob.pe/inicio/-/asset_publisher/ZxXrtRdgbv1r/content/el-indecopi-prepublica-estudio-que-plantea-sugerencias-para-mejorar-la-competencia-en-el-mercado-de-placas-vehiculares-en-beneficio-de-los-usuarios?inheritRedirect=false.

⁶ Coronado, J. *et al.*, "Estudio de Mercado sobre las Condiciones de Competencia en la Manufactura y Distribución de Placas Vehiculares" [Market survey of the conditions of competition in the manufacture and distribution of vehicle number plates], INDECOPI, March 2018. Available at: <https://cde.gestion2.e3.pe/doc/0/0/2/6/4/264151.pdf>.

reorganising the supply and distribution of number plates nationwide, the lead body, the Ministry of Transport and Communications (MTC) decided to enter into an agreement with a single provider without going through a competitive tendering procedure.

19. Additionally, the CLC has taken decisions in response to complaints which, in our view, relate to market situations that are the result of national policies to maintain or boost a strategic industry. Box 1 briefly summarises a case decided by the CLC confirming the existence of a dominant position on the part of a state business whose market position could well be associated with a specific national industrial policy.

Box 1. Dominant position as a result of a national strategy: the case of Aero Servicios vs. Petroperú (Decision No. 009-2010/CLC-INDECOPI)

Petroperú is a government business carrying out activities in the energy sector. In particular, it has a presence along the entire chain for the prospecting, refining, transportation, storage, marketing and distribution of hydrocarbons. The business was established on 24 July 1969 under Decree Law 17753. As in many other Latin American countries, the State has a controlling position in the hydrocarbons sector owing to the sector's importance.

This policy has not changed substantively in recent years. To a certain extent, it became more firmly embedded when the business was authorised to raise resources on the market in order to finance the Talara refinery modernisation project (in Talara province, Piura Region) in the north of the country.

In a case concerning a complaint against Petroperú of abuse of dominant position in the form of an unjustified refusal to sell, the Free Competition Commission (CLC) within Indecopi confirmed the existence of a dominant position in a specific market in aviation fuels. However, the CLC ultimately ruled that the complaint was groundless when it could find no evidence of actual or potential effects on competition.

4. Government industry and its subsidiary role

20. The Constitution of Peru enshrines the principle of the subsidiary nature of government business activity and provides for equal treatment for private investment regardless of its origin. In particular, the Constitution gives a prominent place to free enterprise and, in line with that principle, restricts the State's role to developing supply in markets where there is no private-sector activity.⁷ In particular, the Constitution states that the State may only conduct business activities in a manner that is subsidiary to private-sector activity and only when authorised expressly by law.

⁷ Article 60 of the Constitution provides as follows: "Article 60 – The State recognises economic pluralism. The national economy is based on the co-existence of different forms of property and enterprise. Only where expressly authorised by law, the State may in a subsidiary manner conduct business activity, whether directly or indirectly, on grounds of significant public interest or national importance. Business activity, whether public sector or non-public sector, shall be treated equally in law."

21. Legislative Decree 1044 (DL 1044) provides for the Law on Suppressing Unfair Competition, which prohibits and lays down penalties for acts of unfair competition and breaches of the rules that govern commercial advertising. DL 1044 provides that failure to comply with the provisions of the Constitution concerning government business activity constitutes an act of unfair competition.⁸

22. The Unfair Competition Audit Commission (CFD) at Indecopi is responsible for auditing compliance with DL 1044 and taking decisions at first administrative instance. Those decisions can be appealed under administrative procedures before the Specialised Competition Chamber (the Chamber) of the Indecopi Court (the Court).

23. According to the established case-law on the performance by competent bodies of their duties, and in particular pursuant to the decision of the Chamber laying down important criteria on determining the existence of an infringement of the State's subsidiary role,⁹ in cases of this kind, the CFD must apply the rules, first, by ascertaining the existence of an express law approved by the Peruvian Congress authorising the performance of the activity and, second, by examining whether the activity complies with the requirement to be subsidiary, i.e. whether it meets the needs of a segment of consumers where there is no actual or potential private-sector supply or that supply is insufficient. Finally, the CFD must also ascertain whether the government business activity meets the requirement to be of significant public interest or of national importance.

24. The State's subsidiary role can be justified on the basis of the significant interest of supplying a good or service, especially if the good or service in question is affected with a public interest or will generate positive externalities which, by definition, are in sub-optimum supply on the private market.

25. Outside this basic economic framework, government business activity may distort competition mechanisms to the extent that that activity is not guided by economic incentives. For example, the provision of a service with state-subsidised prices or fees can give rise to distortions in balanced price formation that can jeopardise the sustainability of private business, even when the private sector is operating efficiently.

26. Recently, some state activities such as postal services or power generation have been the subject of complaints to Indecopi on the ground that they are allegedly inconsistent with the principle of the subsidiary role of government business.

27. Where postal services are concerned, in Decision No. 164-2017/CCD-INDECOPI of December 2017, the CFD, ruling at first instance on a complaint by a private messaging services provider against the state business SERPOST of unfair competition in the form of infringement of rules on the subsidiary nature of government business activity, held that the complaint was unfounded. Among other arguments, private-sector provision on the

⁸ Article 14.3 of DL 1044 provides that "The business activity performed by a public entity or state enterprise in breach of Article 60 of the Constitution of Peru shall constitute an act infringing the rules and will be assessed by the authorities enforcing the present Law. In such a case, there shall be no requirement to substantiate the acquisition of a significant advantage on the part of the person pursuing the business activity."

⁹ Decision No. 3134-2010/SC1-INDECOPI laying down the precedent based on a complaint of breach of the principle of the subsidiary nature of government business by the National University of Puno (UNAP).

relevant markets identified was not sufficient, thereby justifying the government business's subsidiary role.

4.1. Finance: FONAFE

28. The state-owned enterprises under central government control are managed by the National Fund for the Financing of Government Business Activity (FONAFE). FONAFE is a company governed by public law under the supervision of the Economy and Finance Sector and created to regulate and guide government business activity.¹⁰ At the time of its creation, FONAFE took on the duties of the now defunct Office for the Institutions and Bodies of the State (OIOE).

29. Its Board comprises cabinet ministers, and its main duties are as follows:

- To hold the shares representing the capital stock of all companies (whether already created or yet to be created) in which the State has a shareholding and to administer the proceeds of those shareholdings.
- To approve the consolidated budget of the companies in which FONAFE is the majority shareholder, within the framework of the relevant budgetary rules.
- To approve the rules of management of those companies.
- To appoint representatives to the General Meetings of Shareholders for the companies in which it is the majority shareholder.

30. FONAFE covers only those companies where the State is the majority shareholder, whether the company in question is active or being wound up. Also within its scope are companies that are assigned to it (*entregadas por encargo*).

31. The management duties of FONAFE include the possibility of providing finance in the form of debt held by the state-owned enterprises within its scope. Accordingly, the competition authority may be interested in the access that these companies have to bank loans or debt that can, with the State's endorsement, give rise to better conditions than those achievable by a private entity, therefore causing some concern around maintaining a level playing field.

32. However, the most up-to-date report on the debt position of state-owned enterprises states that the non-financial companies under FONAFE's umbrella represent only 17% of the total debt. Most of the debt belongs to housing promotion funds and the Development Finance Corporation (COFIDE), a second-tier state funding entity.

33. Additionally, two-thirds of the 17% debt held by FONAFE's non-financial companies is held by the Lima drinking water distribution and sewerage company (SEDAPAL). This company provides a public service in what we understand to be a near natural monopoly situation. Accordingly, the competition is not necessarily efficient. The remaining companies also provide public services, chiefly power, sometimes on a regional basis under enabling legislation, which would also establish that they are affected with a public interest.

¹⁰ Created under Law No. 27170, enacted in September 1999.

34. In short, finance, whether from the public or private sector, that is supplied from state funds or with a state guarantee, to non-financial state-owned enterprises under FONAFE's control is not necessarily a significant concern, since it is directed chiefly at public-service activities that are provided under natural monopoly conditions, or in specific sectors or regions, and could be regarded as subsidiary to private activity. A decision in that regard will nonetheless be contingent upon an individual case study if necessary.

35. There is no evidence that the State assigns Public Treasury resources (collected through taxes, social security contributions or other means) to finance the activities of the companies controlled by the central Government, for example to subsidise those activities.

36. Certain infrastructure projects in telecommunications services are treated differently, such the carrier service and broadband services at district level under the Optical Fibre Backbone Network project and the 21 regional optical fibre carrier networks and their respective broadband access networks (at district level) that supplement the private infrastructures already in place. These infrastructures, along with their operation and maintenance, are financed with state subsidies but operated by private concessionaires that have a presence in the more developed national markets.^{11, 12}

37. Although this overview does not report any systematic delivery to state-owned enterprises of state-backed debt or finance from Treasury resources, the current situation may paradoxically be storing up a number of problems for the future: by seeking sources of income to finance their subsidiary activities, state-owned enterprises are beginning to expand their service base, creating conditions that could give rise to disputes in relation to their subsidiary role.

5. Conclusions

38. Currently, the PNDP oversees, in orderly fashion, the various programmes, projects, actions, etc. geared to promoting national industry. In line with the outline review set out in this paper, PNDP policies do not necessarily give rise to any need for significant concerns in terms of competition. This is because the PNDP focuses on micro, small and medium-sized enterprises and does not produce specific sectoral policies, although it is guided by a coherent supply chain with defined geographical focuses.

39. Another aspect of the analysis is the subsidiary role of government business activity. In Peru, case law and the applicable regulations require government business activity to be expressly authorised by law and subsidiary to private business activity; in other words, it must meet a need for which private provision is non-existent or insufficient. Additionally, the CFD must also ascertain that the government business activity meets the requirement to be of significant public interest or of national importance.

40. A number of landmark cases have so far resulted in findings that no infringement has occurred.

¹¹ See <http://www.proinversion.gob.pe/MODULOS/LAN/landing.aspx?are=0&pfl=1&lan=13&tit=red-dorsal-de-fibra-%C3%B3ptica>.

¹² The designs for the regional projects were commissioned from the Telecommunications Investment Fund (FITEL). Details can be viewed at: <http://www.fitel.gob.pe/pg/proyectos-regionales.php>.

41. However, despite the fact that there are no public finance policies for non-financial government companies, and therefore no concerns about state aid, the current situation may sow the seeds of disputes as to the companies' subsidiary nature. State-owned enterprises may be incentivised to extend the coverage of their services and, in so doing, secure resources from business activities that may be incompatible with the principle that government business activity must be subsidiary to private initiative.