Organisation for Economic Co-operation and Development

DAF/COMP/WD(2023)28

Unclassified

English - Or. English

17 May 2023

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

Advantages and Disadvantages of Competition Welfare Standards – Note by Peru

15 June 2023

This document reproduces a written contribution from Peru submitted for Item 6 of the 140th OECD Competition Committee meeting on 14-16 June 2023.

More documents related to this discussion can be found at https://www.oecd.org/competition/advantages-and-disadvantages-of-competition-welfare-standards-in-competition.htm

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This contribution is aimed at providing a general overview on alternative standards that differ from the consumer welfare standard and the advantages and disadvantages that the Directorate for Investigation and Promotion of Free Competition of Indecopi (hereinafter, "the Directorate") finds in applying each of them. Additionally, a review on the law and decisions taken by the Free Competition Commission of Indecopi (hereinafter, "the Commission") and the Court Specialized in Competition of Indecopi (hereinafter, "the Court") will be made to identify which standards had been used by Indecopi. It will be explained how the application of different standards have evolved over the years.

1. Introduction: Importance of pursuing a clearly defined standard

1. From a public policy perspective, having a clear understanding of the purpose of competition enforcement is key for the competition authority in several layers, including: (i) to assist it in the interpretation of the provisions of the relevant laws and regulations; (ii) to help the authority to find whether some challenged behavior or transaction should be allowed or not; (iii) to design and harmonize the mechanisms that the systems encompasses; and –overall– (iv) to measure the effectiveness of the labor of the competition authorities. That an authority follows a clear standard also benefits companies, consumers and other interested parties, and society in general.

2. To achieve these objectives, the standard that the Competition Policy follows should be deemed sufficiently clear, reasonably predictable, and well-founded in the theory and practice of antitrust. It should also be manageable from a procedural and evidentiary point of view, so as to enhance and not hinder the performance of the authority.

3. Under these premises and following the most well-known criteria internationally, in Peru, the Competition Act[1] and the Merger Review Act[2] recognize as their main purpose to promote economic efficiency in order to enhance consumer welfare.

4. This is not to say that the Peruvian Competition Authority, Indecopi, is not aware of the discussion on other actual or potential goals that agencies may pursue in their respective jurisdictions. Indeed, the discussion is vast and ever-present. The choice of consumer-welfare in our competition laws reflects on a standard that has been –and still is– the best approach that so far our legislation and policy-makers have found to administer this challenging field.

2. Alternatives to the Consumer Welfare Standard

5. In Peru, and at least for the last two decades, Indecopi has equate the purpose of Competition Policy with the consumer welfare standard.

[1] Enacted by means of Legislative Decree 1034 (2008).

[2] Enacted by means of Law 31112 (2021).

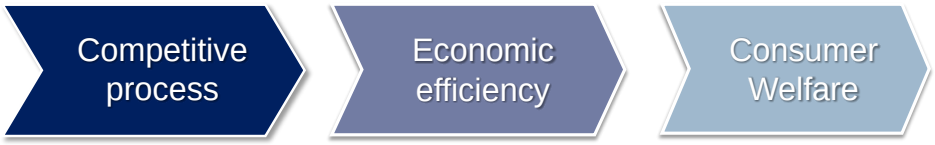
6. Moreover, this standard has been expressly suggested by the Competition Act, enacted in 2008, which recognizes that it challenges anticompetitive behavior in order to promote economic efficiency to enhance consumer welfare:

Peruvian Competition Act

Article 1.- The aim of the Act

The Act forbids and sanctions anticompetitive behavior in order to promote economic efficiency in the markets for the consumers welfare.

Which can be summarized as follows:



7. Because of this definition, it is generally recognized that the aim of competition policy in Peru is to pursue the consumer welfare standard. However, some practitioners believe that its goal is to promote the total welfare standard. Nonetheless, this report will show that, in practice, the competition authority has clearly used the consumer welfare as its standard.

8. In the last few years, other goals of competition policy have arisen in the discussion, and we are aware that –if pursued– they might make a significant difference in the decision-making process of competition authorities. Accordingly, competition agencies should be aware of these new objectives as they ought to take into consideration challenging ideas around their purpose in society, considering human rights, the digital era, climate, equality, liberty, among other objectives that surround public policy discussion.

9. In the next lines, we analyze the theoretical approach of these standards, their characteristics and their main advantages and disadvantages from a competition enforcement point of view.

2.1. The total welfare standard

10. The total welfare standard seeks to measure the effect of a practice or transaction on the economic welfare of all participants in a market, including both producers and consumers. In other words, it refers to the aggregate value created, without regard for how gains or losses are distributed[3]. As such, in contrast to the consumer standard welfare, it will also consider the surplus of companies arising from a challenged behavior or transaction and not only how they could be beneficial or harmful to consumers.

11. As a former FTC commissioner pointed out, if total welfare were the standard, antitrust would "*promote allocative efficiency by ensuring that markets are as competitive as they can practicably be and that firms do not face unreasonable roadblocks to attaining productive efficiency, which refers to both cost minimization and innovation*." In other words, if it were to consider and maximize only economic efficiency, Competition Policy would seek to maximize the total gains from trade. In contrast, to some extent, the consumer welfare standard makes a judgment on the distribution of wealth. The consumer welfare standard measures the surplus that goes to consumers, setting aside what benefit goes to

[3] FEDERAL TRADE COMMISSION. Welfare Standards Underlying Antitrust Enforcement: What You Measure is What You Get? Available on: https://www.ftc.gov/system/files/documents/public_statements/1455663/welfare_standard_speech_-_cmr-wilson.pdf.

sellers. As Hovenkamp argues, "*the consumer welfare principle must therefore be counted as 'distributive' to the extent that it produces outcomes that shift wealth or resources in favor of consumers even though an alternative outcome would produce greater total wealth*."[4]

12. Both standards (consumer welfare and total welfare) consider economic outputs to inform the decision-making process on policies and enforcement. The main difference between them is that while the consumer welfare will be specifically focused on whether the consumer is in a better position, the latter takes into consideration all outputs. Therefore, theoretically, a total welfare standard could allow the consumer to be in a worst situation than it was before the decision if it finds that the outcome is economically efficient for society as a whole.

13. Indeed, by following the total welfare standard, a competition authority could allow a merger that would significantly raise the prices of a product or service if this merger generates efficiencies in the companies involved which achieves an overall more efficient outcome. In contrast, by applying the consumer welfare standard, a merger with these characteristics will not be allowed if some remedies are not imposed to avoid harming the consumers.

14. This has been a debate over decades since most competition authorities have followed one of these goals in their decisions. It is clear how distinct a decision could be in countries that are analyzing similar transactions if one considers a consumer welfare approach, while others use a total welfare approach.

15. The total welfare standard will allow synergies in companies and strictly a more efficient outcome in the society compared to the consumer welfare standard. It is deemed a value-free approach, though this is unlikely. However, impacts on total welfare are not easily determined and could be subject to multiple interpretations.

16. Also, if applied too broadly, it could allow behaviors and transactions that could cause irreparable harm to consumers. In these scenarios, less consumers could afford to buy a product or service or they will have to redistribute their income to purchase these goods (if they are essential) and will have less resources left to buy other products that could be otherwise affordable. A Competition Authority –or any other public body– can hardly allow these results. This negative impact could also have multiple negative effects on society, such as more poverty, call for stronger intervention of the State on the economy, job related impacts, and even reallocation of the population[5].

2.2. The total welfare modified standard

17. Over the last few decades, a new standard –"the total welfare modified standard"– has been considered by some competition authorities. It is deemed a halfway approach between consumer welfare and total welfare standards.

18. While there is still no consensus if this is a standalone standard or just a different application or the total welfare standard, it has been used in Australia, Canada and New Zealand, along other countries of the Commonwealth. The main difference between this standard and the total welfare standard is that the new one takes into account some distributive goals.

[4] Ibid idem.

[5] Later, we will see that this public policy objectives are considered in other competition policy goals.

19. The total welfare modified standard also seeks economic efficiency in that decisions made by the competition authority and does not always require that efficiencies must necessarily be passed on to consumers. Nonetheless, it recognizes that in some circumstances, gains that flow through only to a limited number of members in the community will carry less weight[6].

20. Under this approach, competition authorities will prefer economic efficiency as a general rule, but in cases where consumers that could be particularly harmed or are in a vulnerable state, they will consider that particular situation in order to make a decision.

21. A beneficial characteristic of using this standard is that it will allow distributive effects to be considered in cases where affected consumers are vulnerable –e.g. low income customers in the relevant market of a proposed merger–, and the decision of the authority could be molded in order to avoid harming them.

22. A possible disadvantage of this approach may be that it is not clear when it will be effectively used, thus introducing unpredictability. For instance, the investigation and adjudication bodies of the competition authority may have different conclusions on what type of consumers are vulnerable and these can also change over the. This situation would harm predictability and transparency in the decisions-making process of the authority.

2.3. Citizen welfare standard

23. The citizen welfare standard is relatively new and it has been debated theoretically, although it is not clear if any competition authority has used this standard yet.

24. Citizen's welfare standard seeks to maximize the welfare of citizens, defined broadly to include economic and non-economic concepts of welfare. Notably, such a standard gives weight to citizens as workers, whilst potentially also considering their role as small business owners or even shareholders[7]. The considerations could be as broad as climate change, job related topics, the effects of the digital era, among other public policy objectives.

25. The main disadvantage of using this approach is that –as of today– it is too broad to be practically pursued and each competition authority could consider different policy objectives while deciding. Thus, it lacks predictability. It also lacks reliability and clarity, as it encompasses many different issues, the goals of the Competition Policy could result impossible to define. Additionally, if it gives less weight to economic outcomes, whether related to total welfare or consumer welfare, it loses a key factor in the process of analyzing whether a conduct or transaction could be beneficial or not for society.

26. On the other side, as a potential advantage, this approach considers topics that are currently very important for the wellbeing of all persons, such as equality, liberty to choose, deemed the right to work, poverty issues, among other topics that are not usually consider at deciding on a competition subject. If adequately defined and well-managed his approach could lead to competition policy have a greater impact on society.

[6] BERRY, Mark. Institutional Design Issues and Policy Changes: Reflections from Former Chair of the Commerce Commission. p 241.

[7] Lianos, I. (2018), "Polycentric Competition Law", Current Legal Problems, Vol. 157, pp. 136-140. Available on: https://doi.org/10.1016/J.ECONLET.2017.06.014.

2.4. Protecting competition standard

27. The protecting competition standard criticizes other standards by stating that competition policy, rather than focusing on outcomes and its complexities, should only focus on protecting the process of competition. Many have argued that such an approach would bring practice back in line with the initial motivations for introducing competition laws in the first place[8].

28. The main defender of this standard, has stated that the antitrust law should return to a standard more realistic and suited to the legal system — the "*protection of the competitive process*". He considers judges and lawyers –when assessing a challenged behavior– should ask "*is that conduct actually part of the competitive process, or is it a sufficient deviation as to be unlawful?*". With this view, antitrust law aims to create a body of common-law rules that punish and therefore deter such disruptions — hence "*protecting the competitive process*"[9]. Under this approach, a business practice is judged to be anti-competitive if it harms trading parties on the other side of the market as a result of an unlawful disruption in the competitive process[10].

29. This standard presents the advantage that is going to consider not only how a merger or a conduct could affect consumers, it is going to determine whether the event would hurt the competitive process itself, by taking a look if companies could be harm. Therefore, it does not focus on the consumer or the companies' surplus, but it analyzes whether the companies could compete effectively after a certain practice or transaction.

30. As in other cases, a disadvantage of this approach would be that it may not consider how the consumer could be affected after a given situation. Therefore, a practice that harms consumers can theoretically be allowed if companies are still able to compete and enter or exit the market without barriers.

3. The peruvian experience

31. The first Peruvian Competition Act, the Legislative Decree 701 (hereinafter, DL 701) of November 1991 (in force until 2008), established its objective as follows:

> ***Article 1.-*** *This Act intends to eliminate monopolistic, controlling and restrictive practices of competition in the production and commercialization of goods and in the provision of services,* ***allowing free private initiative to develop itself looking for the biggest benefit towards users and consumers****.*
>
> *[Emphasis added]*

32. As shown, the prohibition of anticompetitive behavior was sought to allow the development of free enterprise (the "*free private initiative*") that would result in a greater benefit of consumers.

33. The emphasis on the elimination of anticompetitive behaviors in order to allow the free exercise of economic liberties would mark the first stage of Peruvian Competition

[8] Khan, L. (2018), "The Ideological Roots of America's Market Power Problem", The Yale Law Journal Forum.

[9] WU, Tim (2018)., "The Protection of the Competitive Process Standard", Columbia Public Research Paper No 14-162.

[10] SALLET, Jonathan (2018). Competitve Edge: Protecting the "competitive process" – the evolution of antitrust enforcement in the United States. Available on: Competitive Edge: Protecting the "competitive process"—the evolution of antitrust enforcement in the United States - Equitable Growth.

Policy after decades of state-controlled economy and would lead the way to decide the first cases regarding antitrust in this initial period (1993-1996).

34. Likewise, it should be highlighted that the article 1 of the Legislative Decree 701 clearly and expressly established that the free development of economic agents (allowed by the elimination of anti-competitive conduct) will result in a greater benefit of users and consumers. Thus, it can be identified with a pro-consumer welfare approach to competition enforcement.

35. Initially, and for a short period, article 7 of the DL 701 also established a scheme for the authorization of agreements, decisions, recommendations, concerted practices or parallel actions in various cases. The first instance or scenario applied when those conducts contributed to improve production, provision or promoting technical or economic progress, and provided that: (i) they share their benefits with consumers; (ii) do not impose restrictions that are not essential to achieve those benefits; and (iii) do not eliminate competition in a substantial part of the market[11]. From this case, and following the goal stated in Article 1, an interest in the consumer welfare can be deduced, since the benefits obtained by the companies had to be shared with the consumers to obtain the authorization of the conduct.

36. The rest of the instances for which prior authorization could be obtained opened the possibility of incorporating other objectives in the application of the Law:

- The second instance allowed authorizing collusive practices whose purpose is to "protect or promote the national export capacity".
- The third scenario allowed authorizing collusive practices that have as their objective "in a conjunctural or temporary way, the adequacy of the offer according to the demand, when a sustained tendency of reduction of that is manifested in the market or when the excessed of productive capacity are clearly uneconomical.
- The fourth instance allowed authorizing collusive practices that "produce a sufficiently significant increase in the standard of living in geographical areas or depressed economic sectors".

37. Then, under these assumptions it can be identified that the application of the old Competition Law could also have considerations such as the objective of promoting exportation, equilibrate markets o to reduce poverty.

38. Some aspects of the original version of the DL 701 were modified in December 1994 with the Legislative Decree 788 (hereinafter, DL 788) and in April 1996 with the Legislative Decree 807. Through DL 788, article 7 –that allowed the authorization of collusive practices under various scenarios that included the promotion of exportation, balancing markets and reducing poverty– was abridged.

39. In these early years (1993-1996), there is a series of cases from which a common factor can be extracted regarding the form of application of the Act. In all of them an interest of the authority to protect the freedom of companies to participate in the markets is identified. In them, moreover, the Commission does not develop arguments related to what it has verified are conducts that harm competition, but rather reveals "unjustified" conduct on the part of the dominant agent. On the other hand, in the emblematic case "Los Portales" (1995) where an abuse of a dominant position was punished for charging in the parking lot at the main airport in Lima. Therefore, there is a consumer protection interest punishing an exploitative practice.

[11] This case is very similar to the count of the rules on competition of the European Union.

40. In the Technical Reports of the Technical Secretariat and the Decisions of the Commission for the period 1996-2002, there are already mentions of "efficiency", "total welfare" and "consumer welfare". The main common factor among the decisions of the period 1996-2002 is the concern of the Commission to protect the competitive process. Indeed, during this period the Commission investigated and solved cases of predatory pricing ("Proquinsa" and "Reckitt"), price discrimination ("Centromin" and "El Comercio vs Aerocontinente"), refuse to deal ("Santa Anita", "Cab Cable", "Aerocontinente vs Banco de Crédito" and "Fernandini") and collusive practices ("Chickens", "Civa" and "SOAT") with a clear interest in protecting competition, preventing competitors in certain markets from damage and/or preserve free and independent competition among market participants.

41. Additionally, in the decisions of many of the cases about abuse of a dominant position, such as those of collusive practices in this period, there is a concern about the repercussions of the investigated conducts on consumers. This can be seen in the decision, for example, of the "Reckitt" case and in the "Chicken" case, to mention just one example for each type of infringement (abuse of a dominant position and collusive practices). The last case of the period, the "SOAT" case is also a notable example of them, by eliminating competition through collusion, also greatly harmed consumers since they were forced to continue buying SOAT, despite high prices of collusion, precisely due to its nature as a compulsory insurance.

42. An interesting fact of the Technical Report of the Technical Secretariat in the "Dino" case (Report 006-2003-INDECOPI/CLC) is that it contains in its theoretical framework a section on "the objective of competition law". Said section establishes that objective of competition law is to protect the competitive process, which ensure efficient performance of the markets, which in turn results in the improvement of consumer welfare.

43. In the decision, the Commission referred in a similar way to the opinion of the Directorate in the "DINO" case, that the objective of the free competition legislation had to do with protecting the competitive process, which seeks an efficient performance of the markets, which in turn result in the improvement of consumer welfare. The Commission noted the following, regarding the objective of competition policy:

> *In terms of competition policies, the final result of the protection of competition and the efficiency of companies will be the maximization of the total surplus (well-being of society), which includes the maximization of the well-being of consumers and users. This last condition being necessary but not sufficient. In this way, the objective of competition legislation is to guarantee and preserve the competitive process, since through this the social welfare, in general, and the welfare of consumers and users in particular, is maximized.*[12]

44. In the "DINO" and "AFP" cases, there is evidence of an express interest of the Commission to protect the competitive process, to the extent that efficient performance of the markets is thus promoted, which in turn results in the improvement of consumer welfare. Accordingly, in the Decision of the Commission of the "AFP" case, it is stated that:

> *[T] he ultimate purpose of a competition policy is to improve consumer welfare, but provided that this improvement is the result of competition (of the competitive process), that is, the result of productive and innovative efficiencies implemented by companies in order to capture consumer preferences.*

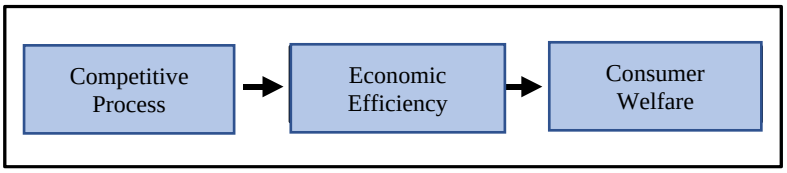
[12] Decision 054-2003-INDECOPI/CLC. Page 24.

In this sense, the objective of the constitutional and the legal framework that protect free competition is none other than to promote the best allocation of resources and to encourage economic efficiency in the markets and, consequently, to seek the greatest well-being of consumers.

The foregoing shows that the legal right protected by competition law is the competitive process itself, since it generates productive and innovative efficiencies in the market and, in turn, these efficiencies maximize the welfare of the consumers.

The competitive process causes suppliers to produce a greater variety of goods or services, at lower prices and better quality, which obviously benefits consumers. Graph No. 1 shows this relationship between the competitive process and the well-being of consumers.

Figure 1.



Note that the constitutional and legal regulations for the defense of competition directly protect the competitive process and only indirectly protect consumers. Indeed, the current legal system is aimed at guaranteeing the promoting and supervisory role of the State over competition. Said norms are intended to prevent conducts that affect the normal development of free private initiative and constitute an organic body conducive to protecting competition as a fundamental mechanism to improve the consumers welfare[13].

45. As part of this synthesis in relation to the application of the Law in this period, it is worth noting the manifestation of a particular phenomenon in some cases, which has to do with the presence of markets whose demand is perfectly inelastic. Such are the cases of "SOAT" and "Pilot". In both cases, the service had to be contracted by the clients or consumers of the insurance and pilotage markets, respectively. The sanction ordered by the Court, in the first case, and the Commission, in the second, would show that, to the extent that the competitive process is affected and the consumer welfare is damaged, a violation of the Competition Act will be found, regardless of whether there is damage to aggregate well-being (economic efficiency). Since, in these cases of perfectly inelastic demand, this last type of damage does not exist, but rather the harmful effects of anticompetitive conduct (in one case a horizontal collusive practice and in the other case an abuse of a dominant position) are suffered directly by costumers or consumers.

46. A determining milestone in the development of Competition Policy in Peru is the issuance of the Legislative Decree 1034 in June 2008 (hereinafter, DL 1034) that replaced DL 701.

47. DL 1034 reformulates the objective of applying the Competition Act in relation to the objective contained in DL 701 to establish it as follows:

Article 1.- Aim of the Act

The Act forbids and sanctions anticompetitive behavior in order to promote economic efficiency in the markets for the consumers welfare.

[13] Decision 054-2003-INDECOPI/CLC. Page. 24 – 25.

48. As can be seen, in this formulation of the objectives of the law, the economic jargon that had previously appeared in the authority's decisions is used, including terms such as "economics efficiency" and "consumer welfare".

49. It is evident that the current formulation of the purpose of the Law comes from the discussions about its objectives that were reflected in some important cases, such as the "DINO", "AFP" or "Consettur" cases. Article 1 of DL 1034 sets aside a more general formulation referring to free enterprise or "free private initiative" contained in Article 1 of DL 701, to replace that portion of the formulation of the objective of the Law expresses the term economic efficiency.

50. The Indecopi case law had already mentioned that this concept reflects what happens in competitive markets: low costs (productive efficiency), prices close to costs (allocative efficiency) and new and better products (innovative efficiency).

51. Notwithstanding this change, the formulation of the objective of the Law concludes in a similar way as in the case of the DL 701 since it establishes the consumers welfare as its ultimate goal.

52. Now, it could be alleged that, to some extent, the economic efficiency–consumer welfare relationship is not fully resolved in the formulation of article 1 of DL 1034 as it, in itself, may not clearly indicate what decision to make when a certain conduct is consistent with economic efficiency but does not lead to improve consumer welfare.

53. Nonetheless, the answer to this dilemma comes from the case law itself, which indicated that the final objective of the elimination of behaviors that harm the competitive process is the well-being of consumers and, therefore, article 1 of DL 1034 favors the effects about consumers. In this case, the interpretation of the objective of the Law is that anticompetitive behaviors are prohibited to promote economic efficiency inasmuch as this results in an enhancement of consumer welfare.

54. Finally, it is noteworthy that in October 2020, Act 31112 was enacted, establishing a Pre Pre-Merger Review System. Until then, Peru only had merger control in place for the electricity sector (Law 26876).

55. Article 1 of the Act 31112 establishes the following goal:

> *Article 1. Objective of the Law*
>
> *The purpose of this law is to establish a regime of prior control of business concentration transactions to promote effective competition and economic efficiency in the markets for the consumers welfare.*

56. Although, as can be seen, this law introduces a reference to the promotion of effective competition, it maintains the concept of economic efficiency as in DL 1034 and establishes a final objective coherent with the consumer welfare standard.