

# Competition

## and Development

### THE POWER OF COMPETITIVE MARKETS

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## Fair-Market Activists Build a Competitive Environment

In Peru, advocacy is key to implementing competition policy.

*If it plays its cards right, a competition authority can instill fair-market values within a society. Early on, Peru's competition authority created allies, educated the public, and found innovative ways to make competition policy work in a developing economy.*

The major challenges facing Peru's competition authority today are to modernize its communications network and deal with the consequences of trade agreements the country has signed with other nations.

It is a remarkably tranquil existence for an agency that was born in a period of turmoil and that passed its early years in a constant state of challenge. The National Institute for the Defence of Competition and Protection of Intellectual Property, INDECOPI by its Spanish acronym, was first established in late 1992. At that time, Peru was instituting a tough new structural adjustment program to stem the political crisis generated by inflation, recession, foreign currency scarcity, and insurgency. Indeed, INDECOPI was part of a package of free market reforms that then-President Alberto Fujimori instituted after he dissolved Congress.

INDECOPI has now matured, says its president Jaime Thorne.

It now "has its place in people's minds," says Beatriz Boza, who ran the agency for close to six years during its period of rapid development in the late 1990s. "The powers of INDECOPI are not questioned," she adds. It is stable and reliable, and that is the source of its power. Its consistency has given it an enviable track record of decisions upheld in judicial courts.

INDECOPI's journey to become a respected authority figure is detailed in the IDRC-supported 2005 study, *Tailor-Made Competition Policy in a Standardizing World: A Study from the Perspective of Developing Economies*.

Boza led the research in association with a non-profit think tank, Instituto Apoyo, and the non-governmental organization, CAD Ciudadanos al Día. The study outlines how INDECOPI overcame the usual implementation challenges



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in developing countries: a lack of technical expertise, an undeveloped competition mindset, a tradition of government intervention, and business people who rely on anticompetitive behaviour to make a profit.

## A one-stop shop

The agency, which began operating in March 1993, is a one-stop shop for market-related matters. In addition to competition law enforcement, it deals with consumer protection, unfair advertising, dumped or subsidized imports, government regulations that restrict market access, technical and regulatory standards, trademarks, patents and copyrights, and bankruptcies.

Such a wide range of responsibilities prompted one government minister to label it a “Frankenstein.”

INDECOPI’s design and operation made it unique among competition authorities. “The agency manages many different statutes ... In any other country these statutes would be regulated by different agencies,” Boza says. It has seven autonomous commissions that specialize in different aspects of the free market, and three offices dealing with intellectual property issues.

INDECOPI spent its first two years on its internal organization and formal duties. “Cases were being filed and handled [...] and the agency was already having an impact on public opinion on two issues: intellectual property violations and a little bit in terms of consumer protection,” Boza recalls.

But in 1995, it embraced the full breadth of its mandate and started to build a robust economic system within the country. As the study points out, the real “challenge was not to supervise the market, but to help create a market to supervise.”

To do that, INDECOPI became something of an activist. It construed its mission as completely restructuring Peru’s market landscape and institutionalizing that transformation. Through a series of initiatives designed to bolster political will, educate all strata of Peruvian society, deter anticompetitive behaviour, and enlist the support of stakeholders in the new economic regime, INDECOPI fashioned a place for itself and its work in Peru.

In its early years, the agency was primarily funded by government transfers. It only partially lived on the fees it collected for trademark registrations and bankruptcy filings. Today, it is almost entirely funded in this manner. Its current budget is 51 million soles (around US\$17.5 million), which Boza marvels at.

“It’s three times more than we ever saw,” she says.



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## Building human capital

To accomplish its task, INDECOPI put competition advocacy at the centre of its strategy. “You can impose sanctions and enforce rights,” says Boza, “but how do you explain to an economy in transition the dictates of the new law and the rights and responsibilities that businesses and individuals have under the new economic regime?”

Before it could educate the rest of the country, the agency had to find a way of recruiting capable staff. There was a need, according to the study, for “qualified, highly knowledgeable and committed staff. INDECOPI, however, suffered from the malady that afflicts many government entities: poor salaries and the perception that state jobs are inferior to those in the private sector.”

An aggressive recruitment policy outside and inside the country garnered what Boza describes as “the brightest and best talent” available. Working at INDECOPI was relabelled a “civil service” and generous education and travel policies added to the agency’s reputation as an excellent training ground for bright and ambitious university graduates.

## Trial by fire

In mid-1995, the first major test of the authority’s mettle appeared in the form of a price-fixing case against wheat-flour producers and their trade association. The case was important for INDECOPI because it helped cement its powers and laid the foundations for future operations.

Alarmed by the rapid, drastic decline in the price of local wheat flour within two months of trade liberalization and

the ensuing price war among domestic producers, the industry's trade association agreed to standardize — and hike — prices in July 1995. Shortly after, AIP, a small association of bakeries in Lima, announced retail bread price increases to offset the rise in the price of flour. Homemakers from Lima's poor neighbourhoods picketed the Ministry of Agriculture in protest.

INDECOPI's first task was to dissuade the government from reverting to old price control practices. As the study explains, INDECOPI sent messages to top policymakers and their advisors pointing out that "only competition policy could ensure fairness for everyone within the free market. As a result the competition authority should be trusted to investigate the case and resolve any anticompetitive behaviour through regulatory sanctions, free of intervention."

After it filed charges against 18 wheat-flour producers, their trade association, and the AIP, INDECOPI tackled the next hurdle: its own lack of expertise and available personnel to conduct a full-scale investigation. It borrowed economists from the Ministry of Economy and Finance and requested technical aid from the United States. The US Department of Justice taught INDECOPI staff how to carry out a large-scale investigation, imparting such tips as the need to quickly seize all the defendant's internal documents before the company realizes their strategic importance.

After painstaking investigative work, INDECOPI's Free Competition Commission fined 11 of the 18 producers for price-fixing. The ruling held up under two rounds of appeals, in 1996 and 1999. The AIP settled and agreed to refrain from recommending bread prices.

Throughout the case, INDECOPI published notices in the newspapers explaining its role and correcting misconceptions about it and its impartiality. The notices gave journalists valuable important information and presented INDECOPI as an organization concerned with transparency and accountability.



IDRC: Yves Beaulieu

Homemakers from Lima's poor neighbourhoods protested against retail bread price increases.

## Competition advocate

Although the case was successful, it highlighted several deficiencies in the legislation that had created the institute. For example, the maximum fine of US\$50 000 did not always constitute a sufficient disincentive. An INDECOPI analysis of the deterrent effect of fines paved the way for legislation in 1996 that allowed it to impose larger penalties. The maximum fine for price-fixing was set at 10 percent of the defendant's sales. The new law also gave INDECOPI robust discovery and investigatory powers.

Having successfully collaborated with the US Department of Justice, INDECOPI began to regularly interact with competition agencies from other countries, including from the Andean Community and MERCOSUR. In the aftermath of the case, however, the institute also concluded that it needed its own pool of experts. This was "the genesis of INDECOPI's decision to assemble a centralized staff of full-time economists and outside consultants," says the study. The Economics Studies Unit today provides detailed market analyses used by the commissions.

The wheat-flour case helped set the model for INDECOPI's advocacy strategy. INDECOPI launched several initiatives. For example, it set up the Consumer Attention Service, which provides the public with free and quick complaint resolution services. It also started publishing resolutions issued by its commissions as a means of informing the public about consumer rights. It introduced educational programs on the free market regime, as well as seminars and conferences with stakeholders such as civil society organizations, judges, and businesses. It increased its communications with the media and provided technical, economic, and legal opinions to Congress.

The emphasis on advocacy led the agency to change the way in which it interacted with market violators: it decided to issue an explanatory warning letter before taking punitive action. According to the study, the institute believed that "rather than exercising regulatory powers," its job was "to identify and provide critical market information that would allow the market to correct its own failures."

## INDECOPI franchises

Also realizing that "alone it had neither the resources nor the political and social capital necessary to achieve the transformation of the society that it had undertaken," INDECOPI launched one of its more innovative ventures: partnerships with well-respected institutions outside of Lima to bring its services to the rest of Peru.

The thinking behind the establishment of these decentralized offices, Boza explains, was that "if fast food franchises can sell meals that look the same, taste the same, feel the same in New York, Berlin, and Lima, why can't we as government officials do the same?"

The practice of franchising created “symbiotic relationships with pre-existing institutions” such as universities, chambers of commerce, and non-governmental organizations, thus requiring very little capital investment. The institutions chosen were well regarded within their communities.

“The advantage is credibility. When we delivered the message it was being internalized and translated by someone who had standing in the local community,” Boza explains.

“It’s not the police officer, it’s not the enforcer, it’s not the idea of the powerful, bureaucratic father figure,” she says. “It’s more the service-oriented mother figure that also has authority and will eventually use sanctions.”

*This case study was written by Debra Anthony, a writer in Mexico City.*

*The views expressed in this case study are those of IDRC-funded researchers and of experts in the field.*

## A respected institution

INDECOPI’s strategies paid off. Each year between 1994 and 2002, a survey of political and economic sector opinion leaders ranked it among the country’s top five most efficient public and private entities. In 1999 and 2000, it occupied the top spot.

In an October 2007 Universidad de Lima survey, people in Lima’s metropolitan area ranked INDECOPI seventh out of 32 state institutions, with a 58 percent approval rating.

INDECOPI has tripled its caseload over the last 15 years and 97 percent of its decisions have been confirmed by judicial courts, says current president Jaime Thorne. Last year the agency handled 46 000 competition cases; they involved consumer protection, unfair advertising, competition, market access, technical standards, and bankruptcy filings.

INDECOPI’s success is due mainly to how it interprets its mission, Boza states. The agency has used its power more to facilitate than enforce.

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