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## Global Forum on Competition

### COMPETITION POLICY AND THE INFORMAL ECONOMY

#### Contribution from Chile

-- Session II --

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## **THE INFORMAL SECTOR AND COMPETITION POLICY: THE CHILEAN FNE'S EXPERIENCE**

--Chile--

### **1. The concept of 'informal sector'**

1. The expression "informal sector" – or sometimes 'informal economy' - has no single meaning in the economic and social theory. One of its fields of application is the labour market, where it identifies people working in an unofficial way, i.e. under no contract, hence not covered by the social security system or by an established social protection net. This first meaning, along with some precisions needed for a formal definition, is the one used by the United Nations International Labour Organisation (ILO)<sup>1</sup>. But this is not the connotation important to us in what follows.

2. The expression also stands for agents and businesses operating outside the legal and regulatory framework – such as, for instance, health care, property rights or the tax system. It can readily be seen that this concept can depict as many informal markets as there are agents and businesses in an economy. In other words, an informal sector can be observed in each economic activity and sector, although informality is predominant in some of these, as is the case of small and medium enterprises.

3. Formally, ILO has set up a conceptual framework for defining informal economy. This definition, adopted by the United Nations Organisation in its National Accounts System (1993), blends together both ranges – business and employment – of the informal economy.

### **2. The informal sector's economic impact**

4. According to the literature, Latin American countries exhibit a large incidence of the informal sector, which contributes to a high rate of black labour (informal employment) and to a low rate of tax compliance. Estimates for the Argentinean economy in 2004, for example, show the relative tax charge in its formal and informal sectors: "According to the Foundation for Latin American Research, the firms that pay their taxes on time and register their employees have a tax incidence of 37.3% of GDP, more than twice the informal sector's, all of which clearly bears negatively on the former's competitiveness. In some cases this can be deemed as unfair competition, able to push formal firms out of the market."

5. Tax considerations are far from being the sole concern caused by the informal sector, since local trade is also harmed. In order to increase and improve to informal sector's regulation, in 2007 the government sponsored a bill<sup>2</sup> on the grounds that "illegal trade is a serious national problem as long as it generates assorted costs and social damage. On the one hand, mention must be made of tax evasion. Besides, in many cases that illicit activity breaks the law of intellectual property thus affecting the claimants of involved rights, along with perverting the copyright system. Third, there is the distortion introduced in the illegal trade's product market, which translates into unfair competition to legitimate businesses. In the tax, sanitary, criminal, and copyright laws, and also in the municipal environment, measures have been taken to fight illegal trade and its harmful effects, to no avail. Defences adopted so far with the purpose of weakening illegal trade have consisted mainly in sanctioning the retailer, that is, they

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<sup>1</sup> ILO introduced the concept of 'informal sector' for the first time in the early 70s, not without controversy, grounded on the complexity, dynamism and diversity of informal activities around the world. Only in 1993 ILO produced a statistically harmonised definition, based on the characteristics of activities and businesses related to the sector. Later on, in 2002, ILO acknowledged that workers and informal activities are not concentrated in one sector (or economic activity) alone, changing the concept to a wider one, from 'informal sector' to 'informal economy'.

<sup>2</sup> Senate's Bulletin N° 5069-03

aim at the final link in the productive chain and hence do not reach producers, managers or supervisors of the organisations behind this illicit activity. This bill intends... to prosecute the organisations and associations devoted to illegal trade, as a way of hindering its origins”.

### **3. The informal sector in Chile**

6. The regular measurement of said sector in Chile is made by the National Statistics Institute, which measures levels and rates of monthly employment and unemployment in the country. The source of its figures is the National Employment Survey, in application since 1986. According to it, the local informal sector accounts for nearly 40% of total employment.

7. A further estimation of the informal economy’s size and characteristics was developed by Sánchez and Labbé<sup>3</sup>, following the ILO methodology and the CASEN<sup>4</sup> survey for 2002. The researchers credited the informal sector with a 46% share, whereas ILO’s data pointed at a 36% share. Finally, a World Bank’s document for 2003 reported that the Chilean informal economy represented a 20% share of GNP, far below the regional average (41%).

8. All these figures betray the fact that the informal economy has not been thoroughly examined in Chile so far. Considering this issue’s importance, the Ministry of Economic Affairs is setting up a research to assess and estimate the informal economy incidence and evolution, based on a household panel data. The outcome from the first instrument is expected for April 2009.

### **4. The Informal Sector and Competition Policy**

9. The Chilean Competition Law’s<sup>5</sup> target is “to promote and defend free competition in markets”. In subsequent articles it states that “the anticompetitive illicit are any deed, act or contract that prevents, restrict or obstruct free competition, or that tends to produce these effects” in a wide sense. The following literals illustrate anticompetitive behaviour, like collusive agreements and abuses of dominant position. The Chilean statute does not consider anticompetitive conducts per se, but analyses the transgression by means of the rule of reason. In this sense the case analysis always includes the definition of the relevant market and the identification of a market power used or obtained in a wrongful way, or—in forward-looking rulings-, whose acquisition generates significant risks of abuses or of coordination in the future market scenario.

10. Due to all this, in Chile the relation between the informal economy and the competition policy is not necessarily clear and straightforward, mainly because the informal economy and informal activities seldom have a market share large enough to result in a dominant position<sup>6</sup>. This is all the more true since 2007, when the Unfair Competition Law was enacted<sup>7</sup>.

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<sup>3</sup> Sánchez, Marlene and Javier Labbé (2004), “The informal sector in Chile: A statistical vision”, *Ciencia y Trabajo*, year 6, N° 14, October.

<sup>4</sup> National Socio-Economic Characterisation Survey (CASEN), used to diagnose and assess the impact of government programmes on households. This survey is carried out by Chile’s Planning Ministry.

<sup>5</sup> DL 211 / 1973 and its amendments, summarised in the DL 1/ 2005 of the Ministry of Economics Affairs.

<sup>6</sup> This framework led to the early dismissal of a number of cases where no background for defining markets or evidence of market power was available.

<sup>7</sup> Law N° 20.169 / 2007.

11. Despite this market power concern, a review of the competition authorities' rulings leads to identify two main issues between the informal economy and competition policy:

- an informal activity harms formal competitors directly by means of unfair practices; and
- informal agents are considered as economic agents, and included in the definition of the relevant market

12. The following cases are empirical examples of both situations:

i) Travel agency case (2000)<sup>8</sup>

Koriana Travel was accused by the FNE of selling air tickets with a substantial discount, allegedly financed by tax evasion. The Commission regarded this conduct as unfair competition and punished the defendant with a fine.

ii) Chiletabacos - A cigarette distribution case (2005)

In this case, concerning the cigarette distribution market, Philip Morris (subsidiary of the Altria Group) accused Chiletabacos (the dominant firm in Chile with more than a 90% market participation and a subsidiary of British American Tobacco) of abusing its dominant position through a series of vertical restraints, such as dealing and exclusivity contracts.

According to Chiletabacos, the 'black market cigarette sales' added up to around 7% or 8% of its market. The Competition Court dismissed the black market figure as an argument for diminishing Chiletabacos' market power. This is the sole case in Chile in which the informal economy has been seen as outlining the relevant market in a competition case.

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<sup>8</sup> Ruling n° 568 / 2000