



**Asia-Pacific
Economic Cooperation**

Advancing Free Trade
for Asia-Pacific **Prosperity**

Promoting Competitiveness: Test of Ex Ante Control of Regulations on Advertising - Sales Promotion

APEC Committee on Trade and Investment

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Asia-Pacific Economic Cooperation

**PROMOTING COMPETITIVENESS:
TEST OF EX ANTE CONTROL OF REGULATIONS ON ADVERTISING
- SALES PROMOTION -**



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EXECUTIVE SUMMARY

The following study was conducted in order to address the recommendations of the Beijing Action Agenda on Advertising Standards and Practice Development (Action Agenda)¹ endorsed by APEC Leaders in 2014. Furthermore, this study directly addresses the Principles for the Government's role in promoting effective advertising standards² endorsed by APEC Ministers in 2015, which provides six principles to promote advertising standards and to meet the APEC Ministers instruction to implement the Beijing Action Agenda.

The objective of this study is to encourage Self-Regulatory Action and Promote Effective Programs by providing APEC economies with an analytical tool to evaluate the impact of regulations in the market, using as case study Peruvian regulations on advertising. In that sense, the Test of Ex Ante Control aims to determine how these regulations affect competitiveness, if they fulfill their stated purposes, and if they affect access to or permanence of the operators in the market.

In our current economic system, private initiative has been considered a way to generate employment and wealth, therefore, our Political Constitution has endowed people with different rights and powers to carry out their business activities. However, there are situations that warrant, even in that scenario, the regulator's participation to protect general welfare.

In this sense, the Regulatory Authority from each APEC economy may intervene in markets, setting access terms, regulating the rights and obligations of economic agents, supervising and overseeing the behavior of economic operators that must be in accordance with the law, and settling disputes that may arise. However, the public sector shall only intervene when it is strictly necessary, i.e. when the regulation to be applied is appropriate and, in turn, is cost-effective.

These aspects are relevant, as the conditions that generate welfare should be established avoiding the introduction of inefficient regulations because this would have a negative impact on the market to the extent that it could reduce competitiveness, injure companies, consumers and even the public sector. Accordingly, it is necessary to establish mechanisms to identify regulations that could be inadequate legal barriers, i.e. whose costs of implementation do not off-set the profits generated in a private initiative, as well as in an environment of economic growth.

1 2014/SOM3/045anx10 (Beijing Action Agenda on Advertising Standards and Practice Development)

2 2015/AMM/015app04 (Principles for the Government's role in promoting effective advertising standards)

**PROMOTING COMPETITIVENESS:
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-SALES PROMOTION-**

I. PREFACE

In 2012, APEC began discussing and promoting regulatory convergence under the *APEC Regulatory Convergence Advancement Mechanism (ARCAM)*. In 2014, the Policy Support Unit (PSU) carried out a study³ to describe the current situation, and the divergences that exist in, advertising regulations and standards across its 21 economies. Thus, PSU recommended APEC to undertake additional work to reduce the identified divergences in specific areas.

Likewise, in 2014, an *Action Agenda on Advertising Standards and Practice Development (Beijing Action Agenda)*⁴ was developed, in which APEC economies agreed that “the goal of aligning advertising standards across the Asia-Pacific region will be conducive to the establishment and delivery of advertising services, which, in turn, will enable business growth, greater regional trade and investment in goods, non-tariff barrier reduction and drive economic growth among APEC economies”. This Action Agenda was endorsed by APEC Ministers “to support the efforts to foster more effective advertising regulation and standards to promote advertising, [...] and encourage(d) economies to undertake efforts to implement its recommendations in 2015”⁵.

Thus, in 2015, the Committee on Trade and Investment (CTI) discussed a work Plan⁶ to continue working on advertising standards, including the formulation of a study on Cost-Effectiveness of Advertising Standards. That same year, APEC Ministers agreed on the *Principles for the Government’s role in promoting effective advertising standards*⁷ where APEC economies commit to the following principles on advertising standards:

- Encourage Self-Regulatory Action
- Provide Advice
- Support Compliance
- Promote Multi-stakeholder Dialogue
- Promote Effective Programs
- Recognize Successful Programs

Peru through a joint collaboration of the National Institute for the Defense of Competition and the Protection of Intellectual Property – INDECOPI and the National Council for Advertising Self- Regulation (CONAR), prepared this document in response to the work plan discussed at CTI and to the 2015 Principles for the Government’s role in promoting effective advertising standards.

In particular, this study addresses the principles in the following sense: Governments have an important role to play in ensuring the positive impact of regulations on advertising in the market, so the Regulatory Authority should guide its activity considering the existing legal framework and how self-regulation can advance consumer protection goals.

3 Voluntary Standards and Regulatory Approaches in Advertising in APEC Economies. Issues paper No.5. APEC Policy Support Unit. April 2014.

4 2014/SOM3/045anx10

5 2014/MM/AMM/14 item 38

6 2015/SOM2/CTI/056

7 2015/AMM/015app04 (Government’s Role in Promoting Effective Advertising Standards: Principles)

Regarding such study, INDECOPI has developed a methodology to detect legal and regulatory barriers that affect competitiveness of economies which would contribute to improve the regulatory framework of APEC economies. This methodology is a tool that not only allows an analysis to detect legal and regulatory barriers in the advertising and commercial activity but can be used in different sectors by APEC economies. Finally, INDECOPI is seeking that APEC economies may review, improve, endorse and apply this methodology so that it may serve as a tool to develop appropriate regulatory policies.

Peru is ruled by a social market economy whose purpose is to ensure –to a great extent– the economic and social welfare of citizens, through a number of guarantees that allow the proper functioning of our economic system. In this regard, it has been considered that “(...) the social market economy is based on the premise that the best system for the allocation and distribution of resources is the one that fosters free agreements between supply and demand, since, in this way, the deployment of human initiatives is promoted, creative competition is encouraged, and technological innovations are supported. In this scheme, the State is responsible for creating the minimum conditions for private economic activities to develop in a free and competitive manner, providing a framework for their efficient development, resulting in better products and competitive prices for consumers and users”⁸.

Therefore, it is observed that “governments seek to achieve competitive markets on the supply side through competition policies aimed at ensuring that there are no unnecessary barriers for the entry of companies, that market concentration does not lead to economic loss or unjustified transfers from consumer to manufacturers, and that effective legal sanctions against fraud, misleading conduct, and collusion between suppliers does exist. When markets exhibit these characteristics, it can be said that they are structurally sound”⁹. It should also be noted that “regulation is one of the three key levers of State’s formal power (along with fiscal and monetary policy) and of critical importance in shaping the welfare of economies and society (...)”¹⁰.

Thus, although there is a set of freedoms and rights granted to private individuals to carry out their business activities, these are not absolute and unlimited, since the Regulatory Authority is empowered to restrict them, provided that its intervention is strictly necessary, i.e. that the regulations¹¹ have adequate justification and, in turn, are more cost-effective. For this reason, it is necessary to examine the hidden costs that may affect market actors, considering that greater regulation is not synonymous with greater welfare, while the key to economic dynamics is to understand that the consumer will benefit whenever he has a greater number of alternatives to choose the one that best suits his needs¹².

In this way, the public sector must exercise its regulatory power with caution, so that it does not create barriers that impede access or permanence in the market of economic agents that nourish competition.

8 Cf. Decision by the Peruvian Constitutional Court (Case 10063-2006-PA/TC)

9 MCAULEY, Ian; SYLVAN, Louise; ERGAS, Henry; FELS, Allan & NIKOMBORIRAK, Deunden. “Políticas públicas de consumo. Tendencias Internacionales”. (Consumer Policies. International Trends) Mexico D.F.: OECD, p. 18

10 OECD. “Recommendation of the Council on Regulatory Policy and Governance”. 2012.

11 In this sense, regulations mean an exercise of sustained and focused control, performed by a public agency on activities that have value to the community. See OGUS, Anthony. “Regulation: Legal Form and Economic Theory”. Oregon: Hart Publishing, 2004, p. 1.

Regulation “[...] is only justified if it achieves at a relatively low cost the policy objectives that a consensus of rational observers would consider to be of public interest.” See BREYER, Stephen. “Analizando el fracaso en la regulación: sobre malas combinaciones, alternativas menos restrictivas y reforma”. (Analyzing the failure of regulations: poor combinations, less restrictive alternatives, and reform.” Themis Revista de Derecho. No. 52, 2006, pp. 4. This paper is further developed in the book by BREYER, Stephen. Regulation and Its Reform. USA: Harvard University Press, 1982.

12 PATRÓN, Carlos. “Un acercamiento preliminar a la función económica de la protección al consumidor”. (A closer look at the economic role of consumer protection) In Ensayos sobre protección al consumidor en el Perú (Essays on Consumer Protection in Peru) (Editor: Óscar Súmar). Lima: Pacific University, 2011, p. 31-32.

In these lines, for example, the Commission for Elimination of Bureaucratic Barriers (CEB for its acronym in Spanish) of the National Institute for the Defense of Competition and Protection of Intellectual Property (INDECOPI for its Spanish acronym), analyzes bureaucratic barriers of the Public Administration *i.e.* any act or provision of government agencies that has the effect of impeding or blocking access or permanence of economic agents in the market, directly modifying the current conditions so they can exercise their activity¹³. In this regard, the work carried out by this body allows us to affirm that there are indeed legal measures that impede or obstruct the business activities of different economic agents, which could be implemented at various regulatory levels.

Under this premise, the public sector is required to establish tools to face inappropriate regulations, considering that legislative measures may generate barriers that impede the access or permanence in the market of economic agents that nourish competition, thereby damaging the market in general, since several options that could be chosen by consumers to satisfy their needs would be excluded.

In that sense, establishing tools to analyze the impact of regulations and legal requirements to perform or develop a specific economic activity is necessary, since this could prevent the passing of inadequate regulations that affect the diverse market participants; *i.e.* companies, consumers, and the public sector.

At this point, it should be remembered that the recommendations of the Council of the Organization for Economic Co-operation and Development (OECD) on Policy and Regulatory Governance includes the integration of the Regulatory Impact Assessment into the early stages of the public policy design process to develop new regulatory projects, highlighting that “(...) improving the documentary basis for regulation through an *ex ante* (prospective) impact assessment of the new regulations is one of the most important tools in the field available to governments. The purpose is to improve the regulation design by helping policymakers to identify and consider more efficient and effective regulatory perspectives, including non-regulatory alternatives, before they make their decisions. One method is to analyze evidence on the costs and profits of the regulation and alternative means to achieve public policy goals, and to identify the perspective likely to yield the greatest net profit to society.”¹⁴

From this perspective, it is necessary to design methodologies for an *ex ante* (prospective) impact assessment, since this would allow, preliminarily, to know the costs and profits provided by a specific market regulation, *i.e.* the positive or negative regulatory effects of the legal measure.

On that basis, we consider that the work carried out by the Peruvian Constitutional Court through the proportionality test provides tools for the evaluation of whether a given regulation serves its intended purpose. Once this aspect is identified, we could use the methodology used by the CEB (developed from the Precedent of Compulsory Compliance, on Case 182-97-TDC¹⁵) as well as the methodology used by the United Nations Conference on Trade and Development (UNCTAD) for the Survey for Measuring the Impact

13 Law 28996 - Law on Elimination of Overruns, Encumbrances and Restrictions on Private Investment. Its article 2 sets out that acts and provisions of the Administration Public entities constitute bureaucratic barriers that establishes requirements, requisites, prohibitions and/or collections for the realization of economic activities, which affect the principles and rules of administrative simplification contained in Law No. 27444 and which limit business competitiveness in the market.

14 OECD. “Recommendation of the Council on Regulatory Policy and Governance”. 2012.

15 INDECOPI. Resolution 182-97-TDC. August 20, 1997.

of Bureaucratic Barriers on the Market¹⁶, using economic and regulatory criteria, in order to carry out a “Test” to predict the negative or positive effects of a given regulation on the market.

In this regard, the proposed methodology will be divided into the three following stages of analysis:

- (i) **Means-Ends Analysis** (Regulatory Perspective),
- (ii) **Analysis of Excessive Burdens** (Economic Perspective), and;
- (iii) **Impact Analysis on Competition and Competitiveness** (Economic-Regulatory Perspective)

The conclusions drawn from the above evaluation will provide us with reasonable evidences to determine whether the regulation in question represents an excessive burden, does not meet its objectives, and, at the same time, damages competitiveness, in which case other options should be considered to prevent the introduction of bureaucratic or statutory barriers that harm consumers and businesses.

Notwithstanding the foregoing, the methodology used could also be useful for an ex post evaluation of regulations¹⁷, however, for the purposes of this analysis, we will be concerned with knowing the benefits of the suggested methodology, from an ex ante evaluation perspective.

Thus, applying the suggested test will provide evidence to support the detection of the possible existence of any statutory barrier (or legal provision of lower rank) that could impede, hinder or block access or permanence of economic agents in the market.

16 UNCTAD. 2011. Estudio de medición del impacto de las barreras burocráticas en el Mercado. (Research on the Impact Assessment of Bureaucratic Barriers). Final Report. Lima

17 OECD (2014). “Estudio de la OCDE sobre la política regulatoria en Colombia. Más allá de la simplificación administrativa”. (Regulatory Policy in Colombia: Going Beyond Administrative Simplification. OECD, Paris. Available in Spanish at: <http://dx.doi.org/10.1787/9789264201965-es>. Especially, it has been emphasized that: “The ex post evaluation of regulations, public policies and institutions is a critical part of the regulatory governance cycle that should be promoted as a permanent activity. The feedback obtained by regulatory bodies from a systematic process of ex post evaluation can make the difference in the way of addressing regulatory problems and helping the regulation to be more effective and efficient. Ex post evaluation is also critical to ensuring that regulatory bodies and their decisions are more subject to public accountability

II. TEST METHODOLOGY

In this section, we will describe the methodology in order to contribute, in a preliminary way, to detect the existence of regulations that may represent inadequate legal barriers, i.e. where the costs of applying such regulation do not off-set the profits earned by private participants nor foster an environment of economic growth (impact on the Gross Domestic Product – GDP or the Economically Active Population - EAP).

In this context, this “Test” is based on the proportionality test applied by the Peruvian Constitutional Court and on the methodology used by the CEB to determine the existence of a bureaucratic barrier¹⁸, as well as on the methodology used by the UNCTAD for the Survey for Measuring the Impact of Bureaucratic Barriers on the Market¹⁹.

In this way, we will explain each stage of the suggested methodology in the following lines in order to then apply them to a specific regulation.

Component I: Means-Ends Analysis (Regulatory Perspective)

This component is analyzed from two perspectives, which are divided into: analysis of the purpose of the rule and analysis of alternative means.

Hence, the first perspective considers the regulations and examines if it is suitable to meet the intended purposes, in other words, in this first stage, we will analyze the means-end causal relationship, determining whether the regulation achieves the intended purpose.

It should be noted that this stage of the analysis resembles the sub-principle of suitability,

18 The case that develops the methodology applied by the CEB is found for the first time in the Binding Precedent handed down in Case 182- 97-TDC. This methodology is divided into two stages, in this paper, we have focused on the one related to the reasonableness of the regulatory measure used. In particular, the precedent indicates the following:

“SECOND: In accordance with the provisions of article 43 of Legislative Decree 807, consider that this resolution constitutes a binding precedent in the application of the following principle:

In order to evaluate whether the requirements imposed by Public Administration entities -including those at the municipal or regional levels- that do not establish taxes, are bureaucratic barriers that unlawfully or unreasonably limit free access to the market, the following interpretative criteria shall be applied:

- First, the Commission -or Court, as applicable- shall evaluate the legality of the contested administrative measure in order to determine whether it has complied with the formalities and procedures laid down by the rules applicable to the particular case and whether it conforms to the powers and competences conferred on the corresponding authority.

For the purposes of the legality analysis, when the contested requirement comes from the application of a legal rule issued by a Public Administration entity, the Commission has the duty to assess the legality of said rule in order to issue a pronouncement regarding the particular case.

- Second, the rationality of the requirement imposed shall be analyzed, considering the following aspects:

a. The plaintiff must provide evidence supporting the possible existence of an irrational bureaucratic barrier that may impede or block access or permanence of economic agents in the market, either because (i) it establishes discriminatory treatment, (ii) it lacks grounds (arbitrary measures) or (iii) it is excessive in relation to its purposes (disproportionate measures).

If there is evidence supporting the existence of an irrational bureaucratic barrier, the Commission shall require the administrative authority to prove the rationality of the contested requirement.

b. In this regard, the defendant is required to prove before the Commission: (i) The public interest that justified the contested measure and the benefits to the community that were expected to obtain with it. (ii) That the burdens or restrictions imposed on the plaintiff were adequate or reasonable, considering the intended purposes. (iii) That there is evidence supporting the conclusion, in general terms, that the contested requirement was one of the least burdensome options for the interested parties in relation to the other options available to achieve the intended purpose.

c. On the basis of the evidence submitted by the defendant, it is for the Commission to take stock of the private costs arising from the contested requirement, compared with the possible public benefits expected, in order to determine the rationality of the measure (i.e. whether it was justified, proportional to the intended purposes, and did not generate discriminatory treatment). It should be recalled that, since the requirements imposed on economic agents generate overrun for the operation of the market, it is for the defendant to prove the rationality of the burdens or restrictions established.” (emphasis added).

19 UNCTAD. 2011. Estudio de medición del impacto de las barreras burocráticas en el Mercado. (Research on the Impact Assessment of Bureaucratic Barriers Final Report. Lima.

defined by the Peruvian Constitutional Court as an analysis that determines, on one hand, that the objective is legitimate and, on the other, that suitability of the measure examined is related with the aim or purpose sought, i.e. that contributes in some way to the protection of the relevant legal right or property²⁰.

As a result, this analysis focuses on whether the adopted means achieves the purpose it is intended to protect²¹ (instrument analysis). Therefore, if the argument of the examination²² shows that the regulation does not achieve the aim pursued but that there could be an apparent justification by the legislator, then we will move to analyze the costs and excessive burdens generated. Nevertheless, we will have prima facie evidence that we are facing an unjustified legal barrier because it fails to protect the purpose that justifies its creation as an imperative rule.

In this regard, if the analysis performed shows the measure actually meet the proposed objective, then we will move on to the second perspective of the component. In this one, a means analysis is carried out, i.e. to determine whether or not there is any other means or tools that achieve the same purpose at a lower cost than the regulations in question.

Therefore, at this point, it is relevant to compare the measure with other tools that are equally suitable to achieve the intended purpose, thus, beyond the regulations having different functions, the practical effect to achieve the purpose sought by the rule analyzed matters. The relationship of this analysis is means vs means or regulation vs regulation.

Thus, this methodology applied even by the Constitutional Court²³ is about comparing the ex ante control with -real or potential- alternative means and available to find the most suitable means to achieve the same purpose, but in a more effective way. It should be added that when performing the analysis in this stage, more qualitative elements will be obtained and, later, in the next part of the component, more quantitative elements will be obtained.

Consequently, if such analysis shows that there are other available tools or regulations that achieve the same purpose, with equal or greater efficacy than the regulations in question, examiners shall continue to the next component, taking into account that we have a second piece of evidence that allows us to conclude that we are facing an unreasonable regulatory barrier, which, on one hand, fails to meet the purposes for which it was created and, on the other, there are other means that serve the same purpose at a lower cost. Given this

20 Cf. Decision handed down in Case 003-2005-PI/TC. For example, the Peruvian Constitutional Court has applied this sub-principle in the Calle de las Pizzas case where the panel found that this principle analyzed whether "(...) the restrictive measure constitutes a suitable or appropriate means for the pursuit of the objective. The restriction on the opening hours of establishments introduced by the Ordinance, precisely in people's rest or sleeping hours, impedes the high noise pollution of the zone to continue during people's rest or sleeping hours, making it possible to provide a healthy sound environment for people to address those needs."

21 Cf. Decision handed down in Case 0048-2004-PI/TC. In this regard, the Peruvian Constitutional Court stated that the "State intervention is considered to be legitimate and in accordance with the Constitution, when it is the result of a reasonable and adequate measure for the purposes of the policies pursued. Hence, it is necessary that this measure does not infringe the fundamental rights of people or, in any case, that this affectation is carried out under principles of reasonableness and proportionality."

22 To this end, it may be convenient to assess the proposed regulation itself, its explanatory statement or any other document or information issued by the authority that would apply this regulation.

23 Cfr. Decision handed down in Case 04677-2004-PA/TC. For instance, the Peruvian Constitutional Court pointed out "(...) although it pursues a constitutionally valid purpose (to protect the historic center as cultural heritage) and uses a suitable means to do so (prohibit meetings within its area of influence); however, by blatantly prohibiting any meeting in the Historic Center of Lima (with the exception of traditional events), (the policymakers) have passed an absolutely unnecessary measure, since the same objective could be reached by evaluating, on a case-by-case basis, the objective, sufficient, and grounded reasons that may justify the adoption of measures restricting the exercise of the right of assembly, where prohibition is a last resort for the administrative authority."

situation, it is necessary to quantify its impact. Thus, the second component analyzes the costs that certain regulations would impose on consumers, companies, the market, and the public sector.

Component II: Analysis of Excessive Burdens (Economic Perspective)

Although the first component is used to assess the standard in relation to its purposes and compared to other equally satisfactory means -all in a qualitative way, this component proposes a methodology to quantify the negative effects of an expensive ex ante or ex post regulations for economic agents in terms of cost, production, and employment. To this end, the study considered as a baseline the survey for measuring the impact of bureaucratic barriers on the market.

The abovementioned study suggests first estimating the **administrative costs** generated by the regulation - which will be defined later - using the **standard cost model** (SCM). Prior to this, the **Materiality Test** is suggested because of its complexity and the high cost of obtaining the information needed, which is done in a qualitative way. Finally, the estimated administrative costs are applied to the **economic multipliers**, which are derived from the input-output matrix, to quantify the production and unrealized employment.

Before providing details on the methodology, the costs generated by the regulations are defined; such costs can be divided into three categories: compliance, financial, and indirect²⁴. As for the first cost, this is divided into two: the costs related to complying with the regulation and **administrative costs**, these are related to the efforts undertaken to prove the Regulatory Authority that the rule is followed, for which information costs must be incurred. Regarding the financial cost, these are the costs related to taxes and burdens imposed by the public sector, while indirect costs are generated by the regulatory impact on the firm through a change in the market structure.

Going into detail in each part of the methodology, the material test must be applied first to justify the evaluation of the regulatory impact, which consists of answering the following questions in a qualitative or quantitative way²⁵:

- (i) Does the regulation introduce (or eliminate) an information requirement?
- (ii) Is there an increase (or decrease) in the frequency of required information?
- (iii) Is a new regulatory area introduced in the company?
- (iv) Does regulation affect a significant number of companies?

The first question is a filter; if no requirement claimed by the regulations generates costs, there would be nothing to estimate. If the answer is yes, the next question is asked; otherwise, the use of the SCM is rejected. The second question gives an indication of whether these costs will increase depending on how many more times information must be submitted to the public sector. At this point, it should be noted that a reduction in the frequency of submission of information does not necessarily mean a decrease in costs, since the new information required may be more expensive.

Continuing with the test, the objective of the third question is to determine whether the regulation is so complex that a company would need to expand, outsource, or add a regulatory department. An affirmative answer to this question further justifies the assessment of the regulatory impact.

24 UNCTAD (2011). Estudio de Medición del Impacto de las Barreras Burocráticas en el Perú. (Research on the Impact Assessment of Bureaucratic Barriers in Peru.) COMPAL Programme.

25 Idem

Regarding the last question, it is advisable to answer it with quantitative data in order to have a measurable data of the percentage of companies affected in the economy²⁶. The higher this percentage is, the more reason to use the standard cost model, although this test should not condition the use of SCM, which allows estimating the total cost of regulation for the economy.

For quantification, it focuses on estimating the **administrative cost** incurred by a firm to demonstrate compliance with the regulation. For this purpose, the following formulas must be used²⁷:

$$\begin{aligned} \text{Total cost} &= \text{Price} \times \text{Quantity} \\ \text{Price} &= \text{Hour Cost} \times \text{Time} \\ \text{Quantity} &= \text{Population} \times \text{Frecuency} \end{aligned}$$

Price is made up of the cost per hour to perform each administrative activity multiplied by the number of hours needed to carry out these activities. And the cost per hour involves two components: the hourly wage and the overhead²⁸. These overheads involve the budget incurred in the inputs, services from the beginning of the documentary preparation, information required, formalities, and procedures, among others.

On the other hand, the quantity is the multiplication of the total of affected companies (population) by the frequency of submission of information. In this way, the cost of regulation for the economy is calculated. This result may be extrapolated to all the companies potentially affected by the regulation in question, which could estimate the potential costs of the regulation.

After estimating the **administrative costs** using the SCM model, these are applied to **the vectors of the economic multipliers** estimated by the National Institute of Statistics and Informatics (INEI for its acronym in Spanish) in 1994²⁹. The objective is to estimate the production and employment that would have been generated if the companies had allocated the resources incurred in implementing the regulation in their respective businesses³⁰. To better visualize the impact in terms of costs, they have been spread throughout the Gross Domestic Product (GDP). This indicates the percentage and, therefore, its importance in relation to the GDP.

Additionally, as a complement to the above mentioned (determining of the average cost of the regulation, employment estimation, and non-generated production), it would be interesting to estimate the impact the regulation would have in the following years. For this purpose, it is suggested to project the number of cases affected by the regulation based on the information submitted by the regulatory body. In line with the above, different scenarios could be assumed regarding the growth of the number of cases in order to estimate a lower and higher threshold of the cost of the regulation for the economy. Then, it would be necessary to estimate the total cost compared to the estimated nominal GDP in the following years, based on the data obtained from the Central Bank or the specialized agency in forecasting the economy's main macroeconomic variables.

26 It is recommended to answer this question also considering the potentially affected companies, to perform an extrapolation exercise to estimate a hypothetical cost for the economy in general.

27 OECD (Source: <http://oecd.org/dataoecd/32/54/734227698.pdf>) and Red de SCM (Source: <http://www.administrative-burdens.com/>), cited by UNCTAD (2011).

28 GONZÁLEZ DE HERRERO, Pablo, CASTRO L y MARIE F. "Una metodología para la medición de los costes administrativos: El Standard Cost Model". Papeles de Evaluación 4. 2006.

29 National Institute of Statistics and Informatics (2001). Multiplicadores de la Economía Peruana. Una aplicación de la Tabla Insumo- Producto 1994

30 The income and occupational multiplier in used to estimate the production and potential employment.

Component III: Impact Analysis on Competition and Competitiveness (Economic-Regulatory Perspective)

This component analyzes how the *ex ante* or *ex post* control of an ineffective regulation can impact the competitiveness of companies. At this point, we must emphasize that companies can compete through prices (Bertrand) or quantities (Cournot)³¹. This level of competitiveness is significantly influenced by the firm's cost structure, since if it is more efficient (lower marginal cost), it will have a greater margin to reduce the price³² and be more competitive.

As a result, higher **administrative costs** would make micro and small-sized companies (MSMEs) less competitive since their sales are lower than those of medium and large-sized companies. In addition, it should be recalled that this cost does not depend on the production of the firm. Therefore, the large companies would have a greater advantage since this cost will dissolve because of their large scale of production, unlike a MSMEs, which does not produce at scale and therefore the administrative cost is more relevant to it.

In line with the above, to determine whether or not the regulation impacts competitiveness, it is suggested to estimate the opportunity cost of the company given the regulation. This in order to estimate how much the economy moves away from the optimal sale due to an ineffective regulation, which means that the market moves away from the Pareto optimum, where the economy efficiently redistributes its resources, produces efficiently and is competitive³³. It should be recognized that the opportunity cost may vary among different sectors and enterprise sizes; however, a factor can be used to have a first approximation of the opportunity cost for the economy. Finally, we must find out what percentage of the GDP this opportunity cost represents in order to evaluate its impact.

31 TIROLE, Jean. "The theory of industrial organization". MIT press. 1998.

32 SHY, O. "Industrial organization: theory and applications". MIT press. 1995.

33 VLADIMIR, C. "Fallas de mercado y regulación económica: ¿La regulación por el gobierno permite lograr un mejor funcionamiento de los mercados?". In Quipukamayoc, 2013.

III. APPLICATION OF THE TEST IN EX ANTE DOCUMENTARY CONTROL OF SALES PROMOTIONS EXERCISED BY ONAGI

A. PRELIMINARY ASPECTS: SALES PROMOTIONS AND ADVERTISING

According to the above mentioned, the Test has been proposed to a specific regulation. In particular, it has been considered that the *ex ante* documentary control of sales promotions is a regulation worth being analyzed under this test. Accordingly, preliminarily we highlight relevant aspects of sales promotions and advertising.

In the market, we notice that economic agents use, as tools for competition, **sales promotions**³⁴ and **advertising**³⁵, which are reflect freedom whereby the companies plan their business so as to attract clients. Such tools facilitate consumers' right to freely choose the good and/or service that satisfies their needs.

At this point, it must be emphasized that consumers have a major role in developing markets since competition is no other than the struggle of competitors to capture the largest number of consumers. In this sense, consumer's free choice will be determining in the final outcome of this rivalry as it is not possible to imagine an economic system of this kind without understanding that the key actor is the consumer.

With this understanding of the tools available to economic agents, we can highlight that sales promotions are a marketing tool used by many companies in several economic sectors that allow to alter the function of consumers' demand as well as to differentiate their product. Under this premise, the implementation of promotions impacts on the economy from a microeconomic perspective by increasing their usefulness and benefits to consumers³⁶, as well as, to companies implementing such tool; and from a macroeconomic perspective by contributing to economic growth since it generates incentives to improve competitiveness among the different economic agents³⁷.

It is worth emphasizing that advertising plays a fundamental role because of the positive impact it has on the market as a tool used by the companies to inform and promote the

34 Firms use promotions for different purposes. One of them is to impact on the demand of their products on its favor through the consumer's utility function since it might modify the consumer's preferences and tastes for a good or service. When a company launches a promotion, it alters the maximum limit the consumer is willing to pay.

35 Going deeper, we may purport that advertising is the manifestation of exercising the freedom of entrepreneurship thereby it informs and persuades the current and potential consumers of the product or service offered by the economic agent. Indeed, within the analysis of advertising as commercial communication, it should be considered that it is not only the manifestation of freedom of speech, but it also permits to offer options to consumers, so they purchase the advertised product or service, and it conveys information on the object advertised to the market. Besides, the doctrine and jurisprudence of the Peruvian Constitutional Court say that "[a]mong the constant activities developed within a company, a paramount one is commercial advertisement, which is backed up by the right to freedom of speech and the right to freedom of entrepreneurship included in Peru's Political Constitution. From combining both rights, the right to freedom of commercial speech emerges comprising advertising". (See the Decision handed down by the Constitutional Court in Case 02976-2012- PA/TC, and Case 00013-2007-PI/TC).

36 A paper (VILLALBA, Francisco Javier. "La Promoción de Ventas y los Beneficios Percibidos por el Consumidor", European Journal of Management and Business Economics Vol. 14, No. 3, p. 2010.) has pointed out that "(...) the economic benefit is not the only benefit obtained by the consumer when purchasing in a promotion. The access to brands of higher quality and the knowledge of new brands and products are benefits even more cherished by the consumer."

37 In this regard, it has been emphasized (ÁLVAREZ ÁLVAREZ, Begoña. "La promoción de ventas como instrumento para modificar el comportamiento de los individuos". Working paper, University of Oviedo. School of Economic Sciences, Nº. 204, 2000. Available on <http://dialnet.unirioja.es/servlet/articulo?codigo=1252831>) that promotions have effects on the consumers' behaviors, since repercussions of using promotional techniques produce observable (short-term and long-term) effects from the moment they are put in motion. In particular, the short-term effect is the increase in sales of the product; meantime, the long-term effect is the possibility of increasing the brand value, aspects related to repurchase and loyalty, changes of brand and expansion of demand; moreover, that fact that consumers may buy in other establishments that offer promotions instead of their regular establishment, or that these establishment offering promotions result more attractive to them.

hiring of services and/or purchasing of goods by consumers, conveying valuable information for their proper decision-making. Moreover, it generates competitive effects fostering greater competition among companies³⁸. All in all, advertising is playing an important role in economic growth because of its level of incidence in the different economic actors participating in the market³⁹. Likewise, nowadays, the digital era has reduced the cost of its use to small- and medium-sized companies; therefore, it is also a relevant tool for these types of companies; hence favorably impacting their growth in the market generating more options for consumers.

Therefore, an adequate legal measure for sales promotions and advertising, based on better business practices, would have the effect of contributing to increase the levels of competitiveness and consumer protection. While economic agents use these tools to promote the hiring of their services and/or purchasing of their goods, such tools also generate incentives for economic agents to position themselves in the market offering better prices and quality. Besides, such tools also generate conditions for competitiveness in innovation in given sectors of the market, which benefits consumers and the economy as a whole.

Sales promotions arise thus as tools that can increase or soften the decrease of sales⁴⁰, considering that promotions persuade consumers by offering more benefits when buying a product, compensating consumers' low real salary.

Indeed, according to a survey conducted by IPSOS Peru⁴¹, consumers prefer sales promotions and impulsive purchases which account for a significant percentage of their acquisitions, even in the lowest socioeconomic levels.

SEL	Interest in promotions
A	69%
B	61%
C	57%
D	43%
E	36%

Source: IPSOS Peru

SEL	Impulsive Purchase
A	75%
B	58%
C	58%
D	43%
E	41%

Source: IPSOS Peru

38 Notwithstanding the foregoing, it cannot be denied a set of negative effects associating advertising with the creation of barriers of access for small-sized companies that cannot compete with the aggressive advertising due to the lack of resources. In such sense, advertising would generate concentration and monopoly because only companies with resources would be able to attract the demand toward their products. However, this stand has been explained from the same point of competition verifying that, albeit the objective of all companies in the market is to maximize its situation aimed at achieving a high concentration of power of the market, it is still an efficient tool so new competitors enter into the market offering better prices and quality. (SÚMAR, Oscar and Julio AVELLANEDA. "Paradojas en la Regulación de la publicidad en el Perú". Lima: Pacific University, pp. 52-53).

39 A paper (BUGHIN, Jacques and SPITTAELS, Steven. "Advertising as an economic-growth engine. The new power of media in the digital age". Available on: http://www.iab-austria.at/wp-content/uploads/2013/03/2012_McKinsey_advertising-role-in-growth.pdf) has stated that investment on advertising can boost the economy in general. In particular, it indicates that for a group of economists, advertising contributes to growth through competition promotion, consumption, and consumers' awareness on the products.

40 RAJI Srinivasan, GARY L., SHRIHARI Sridhar. Should Firms Spend More on Research and Development and Advertising During Recessions? Journal of Marketing, 2011

41 Ipsos Peru: Perfil del ama de casa 2016. Gestión, Monday, July 18, 2016

Hence, sales promotion might increase or soften the fall of sales in a scenario of economic slowdown since promotions might partially alter consumer's purchase intention.

In virtue of the above, all legal measures aimed at restricting both sales promotions and advertising must be examined in the light of a proportionality criterion between the benefits of the measure adopted and the costs it generates in the market since an unjustified restriction to these activities would represent a loss of efficiency and of benefits thereby affecting not only the agents of the competitive process but also the public sector and consumers⁴².

Within such context, the Peruvian legal system is found to have two (2) regulatory mechanisms to ensure the fulfillment of sales promotions: an *ex ante* control and an *ex post* control.

Regarding the *ex ante* control, we note that there is a regulation related to sales promotions, specifically, to modalities of coupons, contests or otherwise, whereby this kind of promotions must be previously authorized by the National Agency of Domestic Affairs (ONAGI for its Spanish acronym)⁴³, which through an *ex ante* documentary control authorizes the companies to perform such activities⁴⁴, without such authorizations, economic agents are prohibited from performing them. Moreover, this regulation enables ONAGI to sanction companies that fail to obtain said authorization and/or fail to meet the conditions thereof. Such measures would have the purpose of protecting participants in a sales promotion⁴⁵.

On the other hand, *ex post* control is governed by a regulation linked to the advertising of sales promotions and the fulfillment of sales promotion addressed to specific consumers. Thus, it has been established that INDECOPI⁴⁶ is the single authority that can oversee and sanction acts against good faith in business and advertising through the Commission on Unfair Competition (CCD for its acronym in Spanish) and specific relations of consumption that fail to meet the conditions offered to consumers through the Consumer Protection Commission (CPC for its acronym in Spanish)⁴⁷. Thus, bodies of INDECOPI are mandated to protect the competitive process and consumers, respectively, by applying the rules on such matters⁴⁸.

At this point, it is necessary to highlight that "meeting the proceedings associated to regulations leads to a direct cost on citizens and companies. Besides, regulation can also

42 Regulation must be the last recourse upon the evaluation and ruling out of other alternatives such as non-intervention, education and information campaigns, structures of market incentives of self-regulation. According to UNCTAD, it is because regulation "has a straight incidence, generally adverse, on competitiveness, capacity of growth and feasibility of companies." See UNCTAD. 2011. Survey for Measuring the Impact of Bureaucratic Barriers on the Market. Final Report. Lima.

43 ONAGI, is an agency designed by the Peruvian State to be in charge of, among others, supervising sales promotions done through drawing of lots and coupons, created by Legislative Decree No.1140. See www.onagi.gob.pe

44 Promotions must be understood in all their modalities, i.e. drawing of lots, contests, coupons, verification of results in informatics systems, acts to check finalists or semi-finalists or the combination thereof.

45 See details of Case 0017-2015-SDC, process related to the elimination of bureaucratic barriers whereon it was requested to come clear the enabling rule that originated DS. 006-2000-I

46 The National Institute for the Defense of Competition and Protection of Intellectual Property is a public specialized body attached to the Office of the Council of Ministers, being a legal entity of domestic public law, created by Law Decree 25868. See www.indecopi.gob.pe

47 Indecopi, through the Consumer Protection Commission (CPC), is the competent and specialized body to settle alleged violations of the provisions contained in the Consumer Protection and Defence Code- Law 29571 - as well as to impose sanctions and corrective measures established therein. Likewise, the Commission on Unfair Competition (CCD) is the functional body of INDECOPI, responsible for ensuring compliance with the rules - Legislative Decree 1044. Law on Suppression of Unfair Competition - which represses unfair competition between economic agents competing in the market.

48 See Law 29571 Consumer Protection and Defence Code. Moreover, the Consumer Protection guidelines set guidelines that, not being binding, guide consumers and suppliers on the criteria for the interpretation of consumer protection rules in the application to differentiate cases shown before the commission. Resolution No. 001-2006-LIN-CPC/INDECOPI

generate barriers that disincentives the companies to participate in the market or diminish the existing competition therein with a prejudicial effect for consumers in terms of price, variety or quality-price ratio.”⁴⁹

Under this premise, it is critical to determine whether the proceeding related to the *ex ante* control for sales promotions generates an unjustified restriction to these activities which would be a loss of efficacy and of benefits that affect the agents of the competitive process, the public sector, and consumers. Therefore, the proposed Test will be used to evaluate such aspects.

Thence, proposals will be developed with the main objective to preserve consumers’ right to have a broader range of options and consumers’ free choice, as well as having real and quick solutions in case of failure to meet them avoiding barriers that affect competitiveness – in particular for micro- and small-sized companies, guaranteeing the constitutional principles and freedoms and, finally, the effective benefit for consumers and the economy as a whole.⁵⁰

B. APPLICATION OF THE TEST TO THE REGULATION IN QUESTION

Once the relevance of sales promotion and advertising in economic relations is understood, the next step is to apply the Test described. To this end, it is necessary to determine what promotion means under the terms of the regulation in question.

In general, the broad concept of sales promotion is included in article 59 of Legislative Decree 1044 – Law on Suppression of Unfair Competition, and it is defined as “any action aimed at fostering the transaction of a product or service offered in temporary and exceptional conditions shown as more advantageous than the standard offer, through price reduction, increase in the quantity, contests, drawing of lots, coupons or similar”. Moreover, it is worth highlighting that INDECOPI’s Defense of Competition Chamber ⁵¹ has constructed that the goal of the mentioned rule is to regulate a special promotion case where (i) the consumer can identify the object being promoted, i.e. it is a determinable offer; and, (ii) its goal is to boost transactions in temporary and exceptional offer conditions so consumers can know or determine what is within the scope of the advertised promotion and then make an informed consumption decision.

Specifically, sales promotions are defined in section (i) of article 5 of Supreme Decree 010-2016-IN, Regulations on Sales Promotions, Charity-aimed Raffles, and Public Collections (hereinafter, Regulations on Promotions), where “sales promotion” is the mechanism or system whereby a prize or prizes under modalities of drawings, contests, sales-coupons, free coupons, prizes, installation or verification of software application, program or system, random prizing, combination thereof or any other alike modality, is offered with the purpose of boosting the sales of products or services.

It is worth stating that, unlike the previous definitions of “promotion”, the current Regulations on Promotions add a given purpose, so the mechanism or system adopted by the economic agent in order to promote that its members or participants fulfill with their

49 UNCTAD. 2011. Survey for Measuring the Impact of Bureaucratic Barriers on the Market. Final Report. Lima. p. 6

50 In this sense, a study carried out by the Congress of Peru (HERNÁNDEZ DE LA CRUZ, Roberto Rubén. “Análisis Costo-Beneficio en los proyectos de ley: problema estructural”. Parliamentary Papers NO. 10 / Second quarter 2014. pp. 57 – 86. Available on http://www4.congreso.gob.pe/DGP/CCEP/revista/2014/ccep_10.pdf) concludes that the cost-benefit analysis does not apply to rules, the economy’s legal security is weakened by the excessive number of rules being binding, overregulation, absence of studies on legislative backgrounds; the study recommends the creation of a public institution that revises the real impact of laws. Nevertheless, we think that this would add more bureaucracy to the system – which is intended to be avoided – and otherwise, INDECOPI must be empowered to conduct such analysis to our regulatory framework.

51 See: Resolution No. 1844-2010/SC1-INDECOPI.

corresponding roles or build loyalty to their integration in certain stakeholder⁵² is defined as “sales promotion”.

Likewise, it is pertinent to indicate that, under the same regulation, it has been set forth that a “sales promotion” is not the regular price reduction of a product or service, the offer of more than one product or service with the sale price equivalent to a single unit of the same or any other similar modality, or the accumulation of points for purchasing some products or services⁵³.

In this sense, the methodology detailed above will be applied to ONAGI’s regulation only to “sales promotions” subject to ex ante control via Legislative Decree 1140 developed in the later regulation: Single Text of Administrative Proceedings (hereinafter, ONAGI’s TUPA), Supreme Decree 010-2016- IN, Regulations on Promotions, and Supreme Decree 011-2016-IN, Regulations on Sanctioning Administrative Proceedings, categorization of infractions, ONAGI’s criteria of severity and setting sanction scales.

At this point, it is worth specifying that other modalities included in the general definition of “sales promotions”, set forth in Legislative Decree 1044, do not require prior authorization for their diffusion.

B.1. Application of the Regulatory Component: Means-Ends Analysis

Pursuant to the above, we must examine whether or not the regulation is suitable to meet the intended purposes, and if so, we must determine if there is any other means or tool that achieves the same purpose at a lower cost.

B.1.1. Determine if the regulation is suitable to meet the intended purposes

Legislative Decree 1140 establishes the ONAGI as a public body attached to the Ministry of Home Affairs, establishing that it is a public institution, administratively, functionally and economically autonomous, which is competent to grant personal warranties, and aims at ensuring the correct development of sales promotions, charity-aimed raffles and public collections; as well as at guiding and supervising the functions of appointed political authorities. In particular, article 6 of such regulatory body establishes that ONAGI’s function is to authorize, supervise, control and oversee sales promotions, charity-aimed raffles, and public collections nationwide. In this sense, according to Legislative Decree 1140, ONAGI has powers related to sales promotions.

In addition, Supreme Decree 003-2013-IN – ONAGI’s Regulations on Organization and Functions specifically regulates aspects related to processing and formalizing authorizations for sales promotions as well as their supervision, oversight, and sanction.

52 Related to this point, it should be noted that sales promotion is integrated into the events conducted by municipalities or guilds that offer some prize to their members or taxpayers (see ONAGI’s Release N° 02-2016-ONAGI). Thus, a sales promotion would be integrated, for instance, into drawing of lots carried out by municipalities aimed that taxpayer timely pay their taxes or conducted by the SUNAT using payment slips. It is worth pointing out that the aim of these examples is not to foster the purchase of a good or service, but to generate public policies to promote timely payment of taxes. In this sense, these rules may affect such promotions that, unlike a commercial purpose, pursue objectives to comply with citizen’s or guild’s duties.

53 ONAGI’s official site complements this definition set forth in the rules on sales promotions with the following exclusions: A sales promotion, according to this document’s terms, is not the regular price reduction of a product or service, the offer of more than one product or service with the sale price equivalent to a single unit of the same or any other similar modality, or the accumulation of points for purchasing some products or services. For example, 2x1, 3x2 sales practices, known as “buy one, take another similar”, “buy two take three”, of similar characteristics, percentages of discount, or discount for the second product or use of a debit or credit card or similar, are not considered sales promotions”. Seen in: <http://www.onagi.gob.pe/portal/index.php?controlador=servicio&accion=detalle&id=15&version=spa>

Likewise, there are several regulatory mechanisms related to said subjects such as: (i) ONAGI's TUPA; (ii) Regulation on Promotions; and, (iii) Regulations on Sanctioning Administrative Proceedings, categorization of infractions, ONAGI's criteria of severity, and setting sanction scales.

At this point, it is necessary to determine the purpose sought through the implementation of such regulation. Conferring upon ONAGI such functions would allow participants of sales promotions to trust that offerors will comply with their offers. In these lines, after the implementation of Legislative Decree 1140, we note that said public body has expressly stated that "(...) ONAGI's function is, among others, to safeguard the legal security and transparency of activities related to sales promotions and charity-aimed raffles, ensuring that the organizing bodies comply with the events according to the authorization and the regulatory framework on the matter, safeguarding good faith and participants' rights; so, in order to provide legal security to the development of such activities, the legal system to which any person or entity with an interest in carrying out said promotions or raffles must be subject."⁵⁴

In addition, it is worth emphasizing that through Official Letter 004-2016-ONAGI-DGAE dated January 26, 2016, such public body indicated that it seeks to safeguard the compliance with the authorization of the promotion, i.e. the form, but neither the content nor advertising of a promotion⁵⁵ and its effects on consumers.

In this regard, infractions included in ONAGI's Regulations on Sanctioning Proceedings are determined by the failures of the form that must be met by sales promotions, foreseen in article 19 of Legislative Decree 1140 and in article 15 of the Regulation. For instance, ONAGI sanctioned a promoting company with a fine of 3.45 UIT (Tax Units)⁵⁶, for partially failing to observe the provisions of Directorial Resolution by promoting unauthorized events, since this conduct is described in article 19 of Legislative Decree 1140⁵⁷.

After analyzing the rules establishing which acts are infractions, it can be determined that all these actions are associated to failures of the form of sales promotions; i.e. that promotions fully comply with the directorial resolution and other documents authorizing the offer of sales promotions. Nevertheless, as previously noted, these must accomplish the intended purpose for which they were established in our legal system, i.e. grant legal security to participants (i.e. consumers) of sales promotions, in other words, trust that they will deliver their commitments.

The only punishable act related to participants is the failure to deliver the prize offered to winners or to deliver prizes other than those authorized. Nevertheless, in this case, jointly interpreting articles 11, 14 and the First Final Complementary Provision of the Regulation on Sanctions, ONAGI is empowered to allot the prizes unclaimed by the beneficiaries to be used in charity activities as part of the social objective of the State.

54 See Directorial Resolution No. 0016-2016-ONAGI-DGSFS-DS dated January 22, 2016.

55 OFFICIAL LETTER 004-2016-ONAGI-DGAE (January 26, 2016)
ONAGI protects participants of a sales promotion. ONAGI has this competence by a law ranked rule (Legislative Decree 1140). As part of these competences, it analyzes the form of the sales promotions, i.e. how the sales promotion will be conducted. In regard with the form, ONAGI evaluates general criteria since it is indispensable to previously know the rules which the participants will be subject to. It is also required that these rules are of public knowledge so the process is transparent, eliminating information asymmetry between the company and participants. ONAGI's role, related to sales promotions, is not to limit them or restrict the market dynamics, but, on the contrary, our entity aims at guaranteeing sales promotion and its development.

56 Tax Unit equivalent to S/ 3 950,00 pursuant to Supreme Decree No. 397-2015-EF whereby it approves its value for year 2016.

57 Resolution No. 0017-2016-ONAGI-DGSFS and 0124-2016-ONAGI-DGSFS-DS dated June 8, 2016. Available at: <http://www.ONAGI.gob.pe/portal/index.php?controlador=sanciones&accion=listar>

In conclusion, we can observe at first sight that the regulations applicable to ONAGI do not confer upon participants (*i.e.*, consumers) of sales promotions, any enforcement mechanisms thereof, focusing only on formal aspects of their realizations. Thus, these infractions can only sanction the lack of authorization for the sales promotion or the failure of conditions granted thereby, but not the consumers deceived by offeror failing to comply with the sales promotion. In other words, the company is not sanctioned for failing to meet the rules on consumer protection or fair competition, but for not having the appropriate authorization for failing to meet the conditions included in the granted authorization, or for failing to meet requirements of the form of the sales promotion.

Additionally, we must specify that the goal of the analyzed regulation should be generating trust on its compliance, without having a tax collection purpose. At this point, we must observe that the specific objective 7 (B) of ONAGI's Institutional Strategic Plan (PEI) 2014 – 2016 states “Increase supervision of compliance with authorization applications for (...) sales promotions”, with a view to increase by 30% the amount collected from fines in order to self-generate incomes to complement the investment and current expenditures (emphasis added)⁵⁸, which shows that the regulation would be used to meet a purpose that is completely different from the one previously identified.

Here, pursuant to the above, we have found serious failures in the purpose of the regulations in question and have noted that incentives are given only for the application documents to obtain an authorization which do not guarantee that consumers can rely that offerors will deliver the sales promotion offered. In conclusion, the measure does not meet the intended purpose. Notwithstanding the foregoing, for the purposes of this analysis, we move on to the second stage of this methodology.

B.1.2. Determine if, compared to the regulations in question, there is any other means or tools that achieve the same purpose at a lower cost

In this stage, we must identify if there is any other means or tools to achieve the same purpose at a lower cost, compared to the regulations in question. For that reason, we deemed pertinent highlighting that the regulations in question would aim at the participants of sales promotions to trust that promotions will be delivered. Therefore, we will identify alternative means aimed at meeting the same purpose proposed by the regulations in question considering that the participants of a sales promotion are necessarily consumers.

Indeed, we must point out that sales promotions impinge on consumers' decisions. In particular, such sales promotions are advertised in the market through advertising⁵⁹, and both are used jointly by economic agents to attract customers. Thus, as for sales promotions, we observe aspects that might impact on the economic dynamics: (i) generally (through advertising); and/or, (ii) specifically (through specific consumer relations).

In virtue of the foregoing, we will briefly describe the features of additional means identified as alternative means to meet the purpose proposed by the regulations in question taking into consideration that these confer incentives to economic agents to not deceive the expectation generated by sales promotions in order to, later, determine whether it meets the same purpose at a lower cost than the regulations in question.

58 See: ONAGI's Institutional Strategic Plan (PEI) 2014 – 2016. Available at: <http://www.onagi.gob.pe/portal/Uploads/transparencia/PEI%202014-2016.pdf>

59 Since advertising is any type of communication spread by any means or support, and objectively appropriate or aimed at promoting hiring or transactions to satisfy its business interest, it can also take place within commercial establishments.

B.1.3. Which means or tools achieve the same purpose as the regulations in question?

As stated, consumers play a relevant role in the economic dynamics therefore, the Regulatory Authority has set measures, so the economic agents' expectations are not let down since such situation might affect the competitive process in general and affect the consumer specifically.

In virtue thereof, we observe that in the Peruvian legal system, the Law on Suppression of Unfair Competition seeks to repress every act or conduct of unfair competition whose goal is, real or potential, to affect or impede the proper functioning of the competitive process including advertising. Moreover, the Consumer Protection and Defense Code safeguards consumers' rights so they have access to adequate products and services, and count with effective mechanisms for their protection in the event of inappropriate offers, reducing information asymmetry, correcting, preventing or eliminating conducts and practices that may affect their legitimate interests.

Although the Law on Suppression of Unfair Competition represses every act of unfair competition even through advertising, great efforts of self-regulatory mechanisms have been currently and complementarily developed in Peru. Therefore, these can be included as a safeguard mechanism in the competitive process in general and for consumers specifically.

Summarizing, such regulatory provisions are alternative means to the *ex ante* control conducted by ONAGI, considering their purpose is to give participants of sales promotions (consumers) the legal certainty or trust that economic agents (suppliers) will deliver since the Regulatory Authority and/or the companies have established compliance mechanisms for the offer promoted. Next, we describe how to achieve the intended purpose.

1. Law on Suppression of Unfair Competition: Advertising of Sales Promotions

Peruvian Legislative Decree 1044 provides sanctions acts that are objectively contrary to good faith in business, irrespective of their form, including commercial advertising. In this sense, any case where advertising of sales promotion misleads consumers or fails to observe any sectorial rule will be sanctioned by the CCD.

On this item, pursuant to Legislative Decree 1044, at the request of the parties or *ex officio*, a precautionary measure can be lodged in any stage of the proceeding in order to ensure the efficacy of the final decision; also, administrative sanctions and, specially, corrective measures can be imposed in the event an act is found to be unfair competition in order to reestablish fair competition in the market altered by an act of the infringing company. Finally, according to the regulatory body, the CCD is also empowered to impose coercive fines to such companies that fail to meet the precautionary measures and/or the given corrective measures.

In this regard, it is worth specifying that the corrective measures and/or sanctions do not jeopardize the indemnity claimed for damages in favor of the affected party who is entitled to claim indemnity for damages with the Judiciary against those identified as liable in the administrative proceeding pursuant to article 58 of Legislative Decree 1044.

Accordingly, there is a significant number of cases related to sales promotions that can be analyzed by the CCD, just because these have been advertised. For instance, in 2010, the CCD analyzed a sales promotion broadcasted by TV which had a directorial resolution issued by ONAGI and determined that such advertisement infringed the principle of legality

contained in article 17 of Legislative Decree 1044. The infraction was caused by a text on the lower part of the screen that did not clearly, prominently, and easily inform recipients of the conditions and restrictions to enjoy the advertised promotion. In that case, a corrective measure ordered the final and immediate cease of the advertising, and the conduct was sanctioned with a fine of two Tax Units (UIT)⁶⁰.

Another example, in 2015 the CCD analyzed an advertising of a sales promotion called “In its tenth anniversary, a newspaper gives you 10 cars for free”. In the printed edition and on its website, such newspaper advertised the drawing of lots for ten Lifan cars, model 620. Such journal advertised the phrase “newest model amazing cars”, insinuating to the consumers that the cars corresponded to 2011. However, the company delivered 2008 Haima branded vehicles. Therefore, such conduct was considered an infringement to the principle of veracity because it misled consumers regarding the characteristics of the prize of the promotion, being an infringement contained in article 8 of Legislative Decree 1044, therefore the advertiser was sanctioned with a 20.06 UIT⁶¹ fine.

Hence, the CCD is an effective oversight body checking advertising of sales promotions and using efficient enforcement mechanisms. The CCD also imposes sanctions in order to discourage advertising practices of unfair competition. So, it can be affirmed that its resolutions will have direct impact on the market since the companies will be encouraged to advertise their sales promotions in accordance with good faith in business.

2. The Consumer Protection and Defense Code: specific consumer relations within the framework of sales promotions

Here, it should be noted that consumers, facing potential infringement of their rights due to offerors failing to deliver sales promotions, even in cases related to commercial advertising that do not provide accurate and/or certain information, are protected by the Consumer Protection and Defense Code.

In this regard, Law 29571 protects consumers by sanctioning conducts and practices that affect their legitimate interests; where the competent body may order corrective measures in their favor. Indeed, when the Code's rules are not complied with, the CPC is the functional body responsible for determining pecuniary sanctions; precautionary measures, where evidence leads the CPC to believe the claim is warranted, based on the legal plausibility and the danger in delay; and corrective remedial measures that allow to offset the direct patrimonial consequences caused to consumers and bringing them back to their previous state.

Likewise, it is necessary to specify that the corrective remedial measures are not compensatory, but they are issued without prejudice to the indemnity for damages that consumers may request in the judicial or arbitral proceeding concerned. In addition, there are complementary corrective measures that serve to reverse the effects of the infringing conduct or prevent its repetition, for example, through the publication of rectifying or informative advertisement aimed at reversing the effects that the infringing act may have caused.

Similarly, article 14 of the Code establishes special rules related to sales promotions, which clearly state the minimum time and number of items offered, otherwise the supplier would be required to provide consumers the products or services offered.

⁶⁰ Final Resolution No. 074-2011/CCD-INDECOPI, Case 243-2010/CCD.

⁶¹ Final Resolution No. 040-2015/CCD-INDECOPI, Case 197-2014/CCD and 198-2014/CCD (Consolidated).

As an example, in 2014, the CPC⁶² found a complaint grounded because a supplier had not delivered the contracted tourist package called “*Viaje Promoción-Cuzco*” as offered and as duly agreed upon by the parties. In this case, a pecuniary sanction of 6.5 UIT was imposed for failing to provide the service according to what was offered, and also the CPC ordered the provider, within a period of five days, to comply with certain corrective measures consisting of refunding the amount paid for the services contained in the promotion and that were not delivered, as well as deliver the gift offered in the promotion.

In another case the same year, the CPC⁶³ found a complaint to be grounded when a supplier was questioned for unjustifiably denying complainant access to a Christmas promotion. In this regard, the CPC confirmed that the supplier had not made available to customers all of the packs offered through advertising brochures. Here, the offer stated that if a customer purchased S/. 149,00 worth of products anywhere in the store, the customer could pay S/. 24.90 to get a “breakfast pack”; the customer would pick the products from the shelves. Similarly, the stock of the said pack was 2000 units in all of the supplier’s stores, both in Lima and Provinces; however, it was verified that the supplier delivered only 1272 packs offered and failed to prove that the products were no longer available when the complainant asked to buy the promotion. Accordingly, the CPC order a pecuniary sanction of 1.5 UIT and ordered as a corrective measure that the store deliver the promotional pack, replacing the products that are not in stock with other similar ones so that the consumer could enjoy such promotion after paying the S/ 24.90.

Hence, the CPC is an effective enforcement body for consumers of sales promotion since the CPC uses efficient mechanisms and imposes sanctions that act as disincentives on practices that might affect consumers’ interests. In this regard, it can be said that CPC’s resolutions will have a direct impact on the market, given that companies will have incentives to deliver their sales promotions.

3. The advertising self-regulation regarding sales promotion

Companies in Peru are opting to establish advertising self-regulation mechanisms. This, of course, generates trust in consumers because the companies seek to establish mechanisms to prevent deceiving consumer expectations with their commercial advertising. In this regard, a relevant case in the analysis of other means that protect consumers efficiently is the one presented to the Standing Committee on Ethics 1 of the National Council for Advertising Self- Regulation (CONAR for its acronym in Spanish). Here, it should be noted that CONAR has a purely proactive approach and whose purpose is not only to quickly and efficiently solve complaints, but also to prevent them from happening by directing their actions to the causes that generate failures or errors in the field of commercial advertising.

For example, in one case it was decided that an advertisement infringed the principle of truthfulness and misled consumers because the secondary message was inconsistent with the main message, given that the advertisement promoted the raffle of a house when the ONAGI’s authorization referred to the delivery of money bonds that could be used to purchase property, pay off a mortgage or part thereof or refurbish a house. The resolution took the following measures: (i) sanction with a written warning to the defendant company; and, (ii) order as a complementary measure the cessation of dissemination of any advertisement of the infringing advertising campaign⁶⁴.

62 Final Resolution 1126-2014/CC2, Case 1507-2013/CC2.

63 Final Resolution 1845-2014/CC2, Case 127-2014/PS3.

64 Final Resolution 09-2012-CONAR/CPE, Case 09-2012-CONAR/CPE.

On the other hand, CONAR provides Copy Advice services whereby advertisers and advertising agencies can request a confidential, non-binding, but specialized opinion, by CONAR's Executive Directorate, on possible contingencies of infraction to the ethical and legal rules governing advertising with respect to a particular advertisement. This service is provided at the request of the advertiser prior to the dissemination of the advertisement and, if possible, offers recommendations in view of the possible contingencies that may arise in relation to the provisions of the Code of Advertising Ethics, the Directives, other codes of advertising ethics in force in the industry, and the rules regulating the advertising activity in Peru.

In this sense, this service reduces costs to advertising companies by promoting good practices avoiding possible infractions, since in many cases investment in the creation and implementation of campaigns could be wasted for not clearly understanding the essential legal bases and ethical principles that govern commercial advertising, i.e. veracity, decency and social appropriateness, fair competition, legality, and authenticity.

Finally, the proactive role of Copy Advice is critical to avoid future disputes through full respect of the regulatory framework, but especially to foster a culture of prevention. For this reason, an important piece of information to consider is that the requests for advice to Copy Advice (51%) exceed the number of complaints settled by the collegiate bodies of CONAR⁶⁵.

B.1.4. Do the means or tools achieve the same purpose at a lower cost than the regulation in question?

According to the above explanations, we observe that there are other means to achieve the purpose of the regulation in question, which serve to regulated ex post compliance with sales promotion by companies or suppliers of products or services. Here, we note that an ex post regulation does not have prior processing costs, so it means that citizens do not incur administrative costs, however it also establishes incentives for economic agents to adjust their behavior, in order not to affect the competitive process or consumers when making and disseminating their sales promotion.

Here, an important aspect in relation to the *ex post* regulation of INDECOPI is that the competent bodies have the power not only to sanction, but also to order corrective measures. In contrast, although the ONAGI's Regulations on Sanctioning Proceedings establishes the power to order corrective measures, this regulation does not include any list or classification to determine the type of measure that is appropriate to the situation of damage. In this regard, the classification and listing allow to differentiate the corrective measures in order to opt for the one that benefits the competitive process or the affected consumer. As is the case with the measures contained in article 55 of Legislative Decree 1044 and articles 114, 115 and 116 of the Consumer Protection and Defense Code, rules duly detailed in previous paragraphs.

In conclusion, there are other mechanisms for ex post regulation and self-regulation of sales promotion in the market, which represent a lower cost for economic agents, greater efficiency in sanctioning infringements, and direct protection of consumers, through precautionary measures safeguarding the effectiveness of the administrative decision, as well as corrective measures to revert the effects of deceiving market promotions or to prevent their recurrence. That is why in our current system of ex post control, it is possible to find real means of protection of the competitive process and the consumer process that

⁶⁵ Calculation of the total number of complaints filed since 2009 before Conar (New Conar Era) plus the total Copy Advice requested from that date to July 25, 2016.

achieve the same purpose at lower costs than the *ex ante* regulation in question, regarding sales promotion.

It has also been observed that despite the fact that a promotion has the authorization of ONAGI, it is not a guarantee that it will ensure the proper functioning of the market and that consumer rights will be protected, given that even complying with it, there could be a situation that affects the expectations generated by the sales promotion, which damages the credibility of the advertising activity and the particular consumer relations. This situation means that other bodies exercise such oversight functions with regard to the proper functioning of the market and the protection of consumer rights, as it is the case of INDECOPI (specifically, CCD and CPC), assisted by CONAR. In response, it can be concluded that the mechanisms of these institutions generate lower costs for companies to achieve the same purpose of the regulation in question.

At this point, having determined the aspects described so far, it is appropriate to determine how much the administrative costs generated to economic agents by the regulation in question would increase; thus, we will move on to the next level of the methodology.

B.2. Application of the Economic Component: Analysis of Excessive Burdens

Usefulness and Objective

In this component, the material test will be applied to give greater support to the use of the standard cost model (SCM). Then, this will be applied to estimate the cost of the *ex ante* documentary control of promotions, as well as the extrapolation of this cost under different scenarios to be defined later.

Measurement

To apply the material test, the 4 questions suggested in the methodology will be answered. On the other hand, although the methodology suggests estimating the total cost using the following formula:

$$\begin{aligned} \text{Total Cost} &= \text{Price} \times \text{Quantity} \\ \text{Price} &= \text{Hour Cost} \times \text{Time} \\ \text{Quantity} &= \text{Population} \times \text{Frequency} \end{aligned}$$

This following formula will be used:

$$\text{Total Cost} = \text{Number of Requests} \times \text{Unit Cost}$$

Since the unit cost of request for promotions depends on the size of the company; that there was no reliable information on the number of hours that an SME would invest in the procedures; and, that the cost of such advice varies based on the size of the company, considering that SMEs do not have the same financial benefits, they do not have high payment capacity like medium and large-sized companies, it can be concluded that the prizes offered by SMEs are lower cost, and therefore do not need a complex procedure as the raffle of a property would require and which only a medium- or large-size company could backup with collaterals to financial institutions.

Therefore, this calculation will be used to find the total cost:

$$\text{Total cost} = \text{NGM} \times \text{CUGM} + \text{NMype} \times \text{CUMype}$$

Where *NGM* and *NMype* is the number of requests from large- and medium-sized companies and SMEs, respectively. While *CUGM* and *CUMype* is the unit cost of request for large- and medium-sized companies and SMEs, respectively.

After estimating the total cost of the *ex ante* control, this cost will be projected for 2016 and 2017. It will also evaluate the impact it has on the GDP, when measuring what percentage it represents.

Information and Data collection

To estimate the unit cost of requesting a promotion, the main costs associated with the request were identified. These involve three components: (i) expenditures on human resources, inputs, and services: S/ 1961,94; (ii) payment of outsourcing to ONAGI (S/1200,00), and (iii) payment of ONAGI's fees: request S/ 323,60 and cost per event S/273,30⁶⁶. The sum of the three components indicates that the unit cost of the regulation in question is equivalent to S/ 3,758.94. However, as mentioned above, SMEs (which do not require complex procedures due to the nature of the goods they promote) will not need to outsource services to agencies that facilitate the process, so the cost of requesting them would be equivalent to S/ 2,558.94 (the total cost of request for advice of medium- and large-sized companies deducting S/ 1,200.00 of outsourcing).

On the other hand, the **number of requests** in 2015 was 5,565. Similarly, 81.13% come from large companies, 10.3% from medium-sized companies and 7.9% from small-sized companies in 2015⁶⁷.

Application

Next, we move on to the Test Material for which the following questions must be answered:

- i) Does the regulation introduce (or eliminate) a requirement of information obligation?
- ii) Is there an increase (or decrease) in the frequency of information obligations?
- iii) Is a new regulatory department established?
- iv) Does regulation affect a significant number of companies?

Answers:

- i) Yes, ONAGI requires firms to present documentation to confirm that the promotion will be delivered when the winner claims the prize.
- ii) Yes, whenever information is requested within the scope of a promotion request or application, it must be submitted. Although it may depend on consumer demand, companies may be encouraged to compete through sales promotion and thus may increase their frequency.
- iii) Yes, currently companies ask law firms and specialized companies to carry out the procedures and/or have dedicated department in their company structure to perform these tasks or to provide support when such tasks are outsourced.

66 Source: nine ANDA advertisers of the following markets: food, beauty and personal hygiene, retail, telecommunications, insurance, household cleaning products and drinks. The individual information of each of these companies is legally confidential.

67 Source: ONAGI. The search of the annual revenues of companies during the 2015 financial statements was performed.

- iv) Yes, currently in Peru, 32.48%⁶⁸ of companies are directly related to sales promotion. 99.5% of them are SME⁶⁹. It should be noted that the following economic sectors relevant to sales promotion were considered: food and drinks, textiles and leather, wholesale and retail sales⁷⁰, lodging activities and food, travel activities and tour operators, other services⁷¹ and entertainment. Thus, these sectors coincide with the sectors with the highest investment in advertising according to the study of advertising investment carried out by Cabello Consultores (2015).

In addition, in the new regulations, through Supreme Decree 010-2016-IN, ONAGI in article 6 establishes that the sales promotions whose value is equal to or less than 15% UIT must comply with the requirements presented in the article 7 (as well as prizes worth more than 15% UIT). Accordingly, an SME is a company that sell less than 150 UIT (according to the tax law). Therefore, with the new regulations, ONAGI will cover all SME that perform sales promotions. Another point to emphasize of the new regulations is that any sales promotion of any institution “municipalities, regional government, professional associations, parents’ associations (APAFAs), public or private educational institutions, public entities, unions, committees, foundations, associations and private law entities”⁷² must meet the same requirements and require approval of ONAGI. Therefore, every SME that is within a sector that competes through promotions, is also covered by the new regulations.

Given the answers, it was found (i) that compulsory information requirements generate costs; (ii) a greater frequency of information submission for each activity related to the promotion; (iii) an outsourcing of the legal service given its complexity (in the case of large- and medium-sized companies); and (iv) impact on a significant percentage of companies in Peru (32.84%). As a result, more support is given to the use of the standard cost model⁷³.

Therefore, the total cost in 2015 is estimated below:

68 Source: Estructura Empresarial 2014 (2014 Business Structure), INEI.

69 Calculations made by the same author, from the following source: “Estructura Empresarial 2014” by INEI. 2014 version was used since there was no information for 2015.

70 Regarding wholesales, it was considered that 26.2% are engaged in sales of food and drinks, and 14.5% in food. While retail sales, 17.0% are supermarkets. Data obtained from Resultados de la Encuesta Económica Anual 2013 (Ejercicio Económico 2012). Características Económicas y Financieras de las Empresas Comerciales en el Perú.

71 Other services were included since finance and insurance companies make promotions.

72 Source: ONAGI, Release No. 020-2016-ONAGI.

73 GONZÁLEZ DE HERRERO, Pablo, CASTRO L and MARIE F (2006). “Una metodología para la medición de los costes administrativos: El Standard Cost Model.” Papeles de Evaluación 4.

Table No. 1

COST OF COMPLYING WITH ONAGI'S DIRECTORIAL RESOLUTION, 2015

Year	ONAGI Requests (A)		RD Cost* (B)		Total Cost	Total Cost
	Large and Medium- Sized Companies	SMEs	Large and Medium- Sized Companies	SMEs	(C)=(A)* (B)	(%GDP*)
2015	5,127	438	S/. 3,758.84	S/. 2,558.94	S/. 20,392,430	0.0033%

**The 2015 GDP figures correspond to the historical nominal value of the 2015 GDP published by BCRP (http://www.bcrp.gob.pe/docs/Estadisticas/Cuadros-Anuales/ACuadro_04.xls), where the figures of the 2016 and 2017 GDPs correspond to the 2017-2019 Revised Multiannual Macroeconomic Framework published by the MEF on August 18, 2016: https://www.mef.gob.pe/contenidos/pol_econ/marco_macro/MMM_2017_2019_Revisado.pdf*

***Source: ONAGI Key: DR: Directorial Resolution – GDP= Gross Domestic Product – MEF= Ministry of Economy and Finance*

It should be remembered that 92.13% of requests come from large- and medium-sized companies; while the rest come from SMEs. Therefore, of the 5,565 requests in 2015 (see Table No. 1), 5,127 cost S/ 3,758.84 and the rest, S/ 2,558.94. Likewise, the GDP at the end of 2015 was S/ 611,970 million⁷⁴. Therefore, the total cost of requesting promotions represented 0.0033% of the 2015 GDP (see Table No. 2).

Also, two scenarios for the growth of requests were projected. The first scenario (growth based on ONAGI's projected history) assumes a growth rate of 3.47%⁷⁵ for 2016 and 2017. In the second scenario (growth based on the projection of private consumption) assumes a growth rate of 3.5 and 3.8%⁷⁶ for 2016 and 2017, respectively.

Likewise, it was assumed that the unit cost for medium- and large-sized companies and SMEs will remain the same in 2016 and 2017 since no significant scale economies would be achieved due to the projected increases. On the other hand, the nominal GDP - following the projections of the Central Reserve Bank of Peru (BCRP) - in 2016 and 2017, and the nominal GDP will be S/ 659,000 and S/ 708,000 billion, respectively (see Table No. 3)⁷⁷.

74 Data obtained from the Central Reserve Bank of Peru.

75 Source: ONAGI. For the calculation of this rate, the number of requests from January to July 2016 was divided by 7 to obtain on average the number of monthly requests. Then, this number was multiplied by 12 to obtain the total number of requests projected during 2016. It should be noted that there would not be some seasonality problem, since the months with the highest number of requests are July and December. Therefore, by including the effect of the season on the date of requests from January to July, it allows to estimate appropriately the total number of requests for 2016. Finally, the growth rate between 2015 and 2016 amounted to 3.47%. This rate is assumed for the growth of requests in the projection of 2017.

76 It was assumed that the growth of requests would be in line with the growth of private consumption. The rates were obtained from the projection of private consumption growth in the BCR inflation report as of March 2016.

77 Data obtained from the Ministry of Economy and Finance in the Multiannual Macroeconomic Framework 2017-2019

Table No. 2

**FIRST SCENARIO: TOTAL ECONOMIC COST PROJECTED OF REQUESTING PROMOTIONS IN
2015 - 2017**

Year: Scenario 1: ONAGI Projected Growth	ONAGI Requests (A)		Cost of requesting promotions (B)		Total Cost (C)=(A)*(B)	Total Cost (%GDP*)
	Large and medium- sized companies	SMEs	Large and medium- sized companies	SMEs		
2015	5,127	438	S/. 3,758.84	S/. 2,558.94	S/. 20,392,430	0.0033%
2016	5,305	453	S/. 3,758.84	S/. 2,558.94	S/. 21,100,707	0.0032%
2017	5,489	469	S/. 3,758.84	S/. 2,558.94	S/. 21,833,585	0.0031%

Source: In-house

Table No. 3

**SECOND SCENARIO: TOTAL ECONOMIC COST PROJECTED OF REQUESTING PROMOTIONS IN
2015 - 2017**

Year: Scenario 2: Private Consumption Growth	ONAGI Requests		Cost of requesting promotions		Total Cost (C)=(A)*(B)	Total Cost (%GDP*)
	(A)		(B)			
	Large and medium- sized companies	SMEs	Large and medium- sized companies	SMEs		
2015	5,127	438	S/. 3,758.84	S/. 2,558.94	S/. 20,392,430	0.0033%
2016	5,306	453	S/. 3,758.84	S/. 2,558.94	S/. 21,106,165	0.0032%
2017	5,508	471	S/. 3,758.84	S/. 2,558.94	S/. 21,908,199	0.0031%

Source: In-house

It should be noted that the gross added value and the employment generated by the economic vectors are not estimated, since the most current data dates back to 1994 and the Peruvian economy has undergone structural changes since, and growth conditions have changed. Therefore, the results would be biased.

Conclusion

From the results found, it is concluded that the total cost of *ex ante* documentary control of the promotions generates a cost on the GDP that represents approximately 0.0033, 0.0032 and 0.0031% for 2015, 2016 and 2017 respectively.

Likewise, in order to emphasize the impact of this study, a study on the elimination of bureaucratic barriers carried out by the Department of Economic Studies of INDECOPI in 2015 is mentioned. In this study, 1,558 barriers were found to be lacking in reasonability and/or were illegal, 379 were unapplied, which resulted in an effective cost of S/ 333.3 million. This study shows that estimated cost as of 2015 represents 6.12% of the S/ 333.3 million detected by INDECOPI. And the average cost of obtaining the prior authorization estimated at S/ 20,392,430 for 2015 is equivalent to 23.2x times the average saving of S/879,419 of the barriers detected by INDECOPI in 2015 (see Table No. 4).

Table No. 4
ECONOMIC COST OF THE NON-IMPLEMENTATION OF BUREAUCRATIC BARRIERS ANALYZED BY INDECOPI, 2015

CEB Comparison	
CEB Barrier Total Saving 2015	S/. 333,300,000
Number of Barriers 2015	379
CEB Barrier AVERAGE Saving 2015 S/.	S/. 879,419.53
CEB Barrier AVERAGE Saving 2015 %	0.27%
Total Cost of promotions 2015	S/. 20,392,943
Total Cost of promotions 2015 / CEB Barrier Total Saving 2015	6.12%
DR Saving 2015/ CEB Barrier AVERAGE Saving 2015	23.2x

Source: In-house. Study on the Elimination of Bureaucratic Barriers, INDECOPI

B.3. Application of the Economic-Normative Component: Analysis of Impact on Competition and Competitiveness

Usefulness and objective

This component will estimate the loss of competitiveness through the opportunity cost of promotions. Although the cost of sales promotion of large- or medium-sized companies and SMEs usually varies, the cost of this sales promotion will be similar for both groups if they decide to offer the same product, for example: the cost of each event (raffle) is

equivalent to S/ 273,30⁷⁸. Also, unlike SMEs, medium- and large-sized companies produce at scale economies, therefore the cost of requesting a promotion is diluted with the greater production in such medium- and large- sized companies-not so much so in SMEs. In this regard, micro- and small-sized companies lose competitiveness to medium- and large-sized companies with the documentary control of promotions since the former would not be able to use this type of promotions subject to ex ante control due to the costs implied in following the process. On the other hand, the risk of recovering the investment made in promotions is higher for SMEs since the large companies are multi-product and diversify the risk of not obtaining sufficient additional demand for the promotion through the sale of their other products, while SMEs do not⁷⁹.

Measurement

To estimate the opportunity cost of the regulations in question, the following formula is applied:

$$Total\ Opportunity\ Cost = \sum_{i=1}^4 P_i \cdot N \cdot V_{tas_i} \cdot Con_i$$

Where $i = 1$: *micro*, 2 : *small*, 3 : *medium* and 4 : *large*. P_i is the participation by company size in the total of requests, N is the total number of requesting companies, is the annual sale (income) by company size, and is the contribution (or participation) of a promotion over the total income by company size.

Then, an extrapolation of the potential opportunity cost will be made to the total number of companies directly affected by sales promotion, *i.e.* those that perform them. To do this, 3 scenarios will be assumed in relation to those potentially affected companies: 1) 100% make a promotion; 2) only 50% make a promotion; and 3) only 33% make a promotion.

Information and data collection

To estimate the **average income** by company size, the 2014 National Superintendency of Tax Administration (SUNAT for its acronym in Spanish) taxpayer database was considered. Such database includes the distribution of the companies based on the amount of annual sales by range. Also, for each range, we obtained the average income a company would earn annually. It should be noted that this database does not mention how much a large company earns on average, *i.e.* those companies selling more than 2,300 UITs per year. For this calculation, the upper threshold was the average sales of nine companies from the National Advertisers Association (ANDA for its acronym in Spanish) from the following markets: food, beauty and personal hygiene products, retail, telecommunications, insurance and household cleaning products, and as lower threshold, annual sales of 2,300 UITs. In this way, both thresholds were averaged to estimate the annual income of a large company. As a result, a large company generates an average sale of S/ 550.3 million (see Table No. 5).

⁷⁸ Source: TUPA ONAGI

⁷⁹ SERRANO F. and César S. (2005). *Gestión, dirección y estrategias de producto*. (Product management, direction and strategies.)

Table No. 5

SALES RANGE BY COMPANY SIZE ACCORDING TO SUNAT'S TAXPAYER CLASSIFICATION, 2014

Company Size	Annual Sales Range (UIT)		Annual Average Income S/.	Participation by company size	Number of Companies
Micro-companies	0	2	S/. 3,950	32.1%	487,936
	2	5	S/. 13,825	9.5%	144,828
	5	13	S/. 35,550	18.0%	272,627
	13	25	S/. 75,050	27.4%	415,903
	25	50	S/. 148,125	6.3%	95,108
	50	75	S/. 246,875	3.0%	44,911
	75	100	S/. 345,625	1.8%	26,659
	100	150	S/. 493,750	2.0%	30,312
Small-companies	150	300	S/. 888,750	46.8%	33,401
	300	500	S/. 1,580,000	24.0%	17,143
	500	850	S/. 2,666,250	16.1%	11,466
	850	1700	S/. 5,036,250	13.0%	9,303
Medium-companies	1700	2300	S/. 7,900,000	100.0%	2,635
Large-companies	2300	2300+	S/. 550,319,500	100.0%	8,388

Prepared In-house.

Source: SUNAT. 2014 Taxpayer Database

Then, to estimate the **average sales** by company size, a weighted sum of the average annual income was made, taking as weight the participation by company size. Thus, the average income by company size was obtained (see Table No. 6).

Table No. 6

AVERAGE INCOME BY COMPANY SIZE ACCORDING TO SUNAT'S TAXPAYER CLASSIFICATION, 2014

Average Income	
Micro-companies	S/. 62,038
Small-companies	S/. 1,881,768
Medium- companies	S/. 7,900,000
Large-companies	S/. 550,319,500

Prepared In-house.

Source: SUNAT. 2014 Taxpayer Database

Regarding the **contribution of promotions** on the income by company size was assumed that this would represent 3% of the total income⁸⁰ approximately. Also, based on information from ONAGI, in 2015, large companies held eight promotions; medium companies, three promotions; and small companies, only one.

Since micro-companies did not request sales promotion authorizations because they were not required to do so in 2015 (but, as of July 2016, they are subject to prior authorization, according to the new regulations when such promotions offer prizes worth less than 15% of UIT), it will be assumed that they also carry out one sales promotion per year. In this regard, if a large company makes eight promotions and their total contributes 3% to their total income, each promotion contributes approximately 0.4% (3%/8) to the annual revenues. According to this, a promotion in a medium company generates a growth of 1.0% (3%/3); while in an SME, 3% (3%/1).

As for the **total number of requests** in 2015, 5,565 sales promotion were requested based on information provided by ONAGI.

In order to estimate the total number of **affected companies** we used the document published by INEI about the Peru's corporate structure in 2014 because the SUNAT's taxpayer database does not detail the number of companies within the commercial, manufacturing, and service subsectors.

For the manufacturing sector, the following subsectors were considered: food and drinks, textiles, and leather. For the commercial sector: wholesale and retail sales were considered⁸¹. For the service sector, companies engaged in lodging activities and food, travel activities and tour operators, other services⁸² and entertainment were considered. Thus, these sectors coincide with the sectors with the highest investment in advertising based on the study of advertising investment carried out by Cabello Consultores (2015).

80 Source: nine ANDA advertisers of the following markets: food, beauty and personal hygiene, retail, telecommunications, insurance, household cleaning products and drinks. The individual information of each of these companies is legally confidential.

81 Regarding wholesales, it was considered that 26.2% are engaged in sales of food and drinks, and 14.5% in food. While retail sales, 17.0% are supermarkets. Data obtained from Resultados de la Encuesta Económica Anual 2013 (Ejercicio Económico 2012). Características Económicas y Financieras de las Empresas Comerciales en el Perú.

82 Other services were included since finance and insurance companies make promotions.

The total number of companies represented 32.48% of the total considered by INEI. It should be noted that this percentage will be applied to the total number of companies that SUNAT shows in its taxpayer database, which is equal to 1,600,620 companies.

Finally, to estimate the share each company size would have in the extrapolation, their share within the total proportion of companies according to the SUNAT's taxpayer database (see Table No. 7) is considered. Thus, the participation of micro companies is 94.86%; small companies, 4.46%; medium companies, 0.16%, and large companies, 0.52%.

Table No. 7

ANNUAL SALES ESTIMATION GENERATED BY THE USE OF SALES PROMOTIONS BY COMPANY SIZE ACCORDING TO SUNAT'S TAXPAYER CLASSIFICATION, 2014

	Average Income	Number of companies	Annual Sale (In millions S/.)
Micro-companies	S/. 62,038	-	S/. 0
Small-companies	S/. 1,881,768	63.67	S/. 120
Medium- companies	S/. 7,900,000	83.02	S/. 656
Large-companies	S/. 550,319,500	659.31	S/. 362.830

Prepared In-house.

Source: SUNAT 2014 Taxpayer Database

It should also be noted that annual sales will vary depending on the company size. Pursuant to the tax law⁸³, micro-companies are those with annual sales of up to 150 UITs; small companies, between 150 and 1,700 UITs; medium-sized companies, between 1,700 and 2,300 UITs, and large companies, with annual sales higher than 2,300 UITs. Also, 81.13% of the companies requesting promotions authorizations are large companies; 10.3%, medium-size companies, and the rest small companies in 2015⁸⁴. Micro companies are not included. Similarly, the company distribution by economic activity was: 74.0% commercial companies, 19.8% service companies, and 6.2% manufacturing companies, based on information provided by ONAGI.

Similarly, if only the number of requests in 2015 (5,565) is considered, and if these are pro-rated throughout the total number of companies by size and economic sector, it turns out that in 2015 the manufacturing, trade, and service sector incurred costs of S/ 1.27, S/15.09, and S/ 4.04 million respectively.

83 According to article 5 of law 30056, law that modifies various laws to facilitate investment, boost productive development and business growth.

84 During 2015, 806 companies requested sales promotions.

Application

Regarding the estimation of the opportunity cost for the economy in 2015, for the 5,565 requests, the following result was obtained (see Table No. 8):

Table No. 8

OPPORTUNITY COST ESTIMATION FOR NOT MAKING SALES PROMOTIONS IN TERMS OF SALES BY COMPANY SIZE, 2015

Company Size	Participation	Number of Companies (806)	2015 Sales (millions)	Opportunity cost (millions)	Opportunity cost/GDP
Small-companies	7.90%	64	S/. 119.82	S/. 359	0.001%
Medium-companies	10.30%	83	S/. 655.84	S/. 6.56	0.001%
Large-companies	81.80%	659	S/. 362,830.05	S/. 1,360.61	0.222%
Total	100.00%	806	S/. 363,605.71	S/. 1,370.77	0.224%

Source: In-house.

In total, the opportunity cost was equal to S/ 1,370 million, and this represented 0.224% of the GDP in 2015.

On the other hand, three scenarios were used based on the number of potentially affected firms: 1) 100% make a promotion, 2) 50% make a promotion, and 3) 33% make one promotion per year. The following figures were obtained (see Table No. 9):

Table No. 9

**OPPORTUNITY COST ESTIMATION– FOR NOT MAKING SALES PROMOTIONS IN TERMS OF SALES
BY COMPANY SIZE AND SCENARIOS, 2015**

Scenario 1) 100%

Company Size	Share	Number of Companies	2015 Sales (S/. MM)	Opportunity cost (millions)	Opportunit cost/2015 GDP
Micro-companies	94.86%	493139	S/. 30,593.19	S/. 917.80	0.15%
Small-companies	4.46%	2362	S/. 43,586.38	S/. 1,307.59	0.21%
Medium-companies	0.16%	856	S/. 6,761.20	S/. 67.61	0.01%
Large-companies	0.52%	2724	S/. 1,499,302.77	S/. 5,622.39	0.92%
Total	100.00%	519881	S/. 1,580,243.54	S/. 7,915.38	1.29%

Source: 2014 SUNAT's Taxpayer Database and INEI Corporate Structure 2014.

Scenario 2) 50%

Company Size	Share	Number of Companies	2015 Sales (S/. MM)	Opportunity cost (millions)	Opportunit cost/2015 GDP
Micro-companies	94.86%	246569	S/. 15,296.59	S/. 458.90	0.07%
Small-companies	4.46%	11581	S/. 21,793.19	S/. 653.80	0.11%
Medium-companies	0.16%	482	S/. 3,380.60	S/. 33.81	0.01%
Large-companies	0.52%	1362	S/. 749,651.39	S/. 2,811.19	0.46%
Total	100.00%	259947	S/. 790,121.77	S/. 3,957.69	0.65%

Source: 2014 SUNAT's Taxpayer Database and INEI Corporate Structure 2014.

Scenario 3) 33%

Company Size	Share	Number of Companies	2015 Sales (S/. MM)	Opportunity cost (millions)	Opportunity cost/2015 GDP
Micro-companies	94.86%	162736	S/. 10,095.75	S/. 302.87	0.05%
Small-companies	4.46%	7644	S/. 14,383.51	S/. 431.51	0.07%
Medium-companies	0.16%	282	S/. 2,231.20	S/. 22.31	0.00%
Large-companies	0.52%	899	S/. 494,769.92	S/. 1,855.39	0.30%
Total	100.00%	171561	S/. 521,480.37	S/. 2,612.08	0.43%

Source: 2014 SUNAT's Taxpayer Database and INEI Corporate Structure 2014.

Given the three scenarios, we notice that if all the potentially affected companies carried out one promotion per year, an opportunity cost of S/ 7,915.38 million would be generated, representing 1.29% of the GDP. Also, in a conservative case (scenario 3), regulations would cost the GDP 0.43%. On the other hand, as expected, large companies represent the group with most costs incurred, followed by small companies.

Conclusion

In conclusion, 3% of sales may seem to be irrelevant, but when we notice the cost that the economy might incur in terms of GDP, the potential impact of the *ex ante* documentary regulations on the total production for the economy becomes significant. Thus, the ONAGI's *ex ante* control generates externalities that must be assumed by society as a whole (companies and consumers). As a consequence, companies' production would be below the optimum given the lack of competition promotions could encourage as a result of the regulations⁸⁵. Another point to be made is that when SMEs are not making promotions, they also incur opportunity costs of unrealized sales. A percentage of these non-generated profits could be reinvested in the company (in physical or human capital) in the following period and thus contribute to its growth.

85 GUZMÁN, Eugenio (1993). Teoría de la regulación, grupos de interés y burocracia. Un marco para la discusión. Revista de Ciencia Política, (Theory of regulation, interest groups and bureaucracy. A framework for discussion. Journal of Political Science,) vol. 15, no 1-2, p. 211-234.

IV. CONCLUSIONS

1. The *Ex Ante* Control Test is an analytical tool to evaluate the impact of regulations in the market. Also, it aims to determine how regulations affect competitiveness, whether they fulfill their stated purposes, and whether they affect access to or permanence of the operators in the market.
2. Applying the Test will provide evidence to support the detection of any legislative barrier that could block access or permanence of economic agents in the market. This will benefit governments through more tailored regulatory activity; industry, through better self-regulation practices; and consumers, through more decisions more consistent with their expectations.
3. A proper legal measure for sales promotions and advertising based on better business practices would have the effect of increasing the levels of competitiveness and responsibility of the consumer, because these are tools used by economic agents to promote the hiring of their services and/or purchase of their goods.

V. PROPOSED FURTHER STEPS

1. Elaborate the final methodology of the Test using the contributions received by APEC economies.
2. Share the final methodology of the Test with APEC economies, international agencies and Self-Regulatory organizations as an indicative tool that allows to detect efficiently and timely commercial and advertising regulations that could be creating barriers to market access and therefore that require subsequent elimination, amendment, and/or self-regulation.
3. Organize workshops/seminars to exchange points of views on sales promotion and advertisement, taking into consideration the conclusions obtained from the tests performed.

ANNEX: METHODOLOGY SUMMARY

-TEST STRUCTURE - Regulation & Advertisement		
Component I: Regulatory Perspective (Ends and Means)		
Description	Indicator	Data
<p>Analysis of the purpose of the rule: Establish the purpose of the regulation and the relationship between the mechanisms established and the purpose pursued.</p> <p>As an example, answer the following questions:</p> <ul style="list-style-type: none"> • What is the purpose of the rule? • Does the rule achieve this purpose efficiently? 	Legal Framework	Legal Framework Explanatory Statement Documents needed to interpret the rule
<p>Means Analysis: Identify the mechanisms that exist and may exist, and that serve the same purpose pursued by the rule in question. The following questions will be answered in this stage:</p> <p>Are there or may there be other mechanisms that achieve the purpose pursued by the regulation under analysis?</p> <p>Are they the same or better suited to achieve the purpose pursued by the regulation under analysis?</p> <p>If the result is positive in both cases, we go on to confront the regulations in question with the other means, in order to identify the rule that achieves the purpose pursued, at a lower cost.</p> <p style="padding-left: 40px;">Rule under analysis vs. Mechanism 1. Mechanism 2. Mechanism 3.</p>	Means vs Means Comparison	Regulatory Matrix

Component II: Economic Perspective (Excessive burden)

Expenses incurred to demonstrate regulatory compliance.	Administrative Cost	Statistics of 9 companies from different economic sectors belonging to ANDA
Potential costs incurred to demonstrate regulatory compliance	Aggregate Administrative Cost	2014 Peru Business Structure (Estructura Empresarial Perú: 2014). INEI
Indicates how much employment and production is generated by investing in certain economic sectors.	Employment and Production Multiplier	Los Multiplicadores de la Economía (1994). INEI
Projection of the demand of the regulator or entity that applies the regulation.	Projections of the number of applications	ONAGI Statistics

Component III: Regulatory and Economic Perspective (Competition - Competitiveness)

Accessibility of companies by size that benefit from a specific tool.	Ratio of applicant SMEs (in the example; Scene 1: in-person procedure –Scene 2: online procedure)	ONAGI Statistics
Sales and/or profits not made due to the regulation based on the projection made in Component II.	Opportunity cost	Projection of the demand made from the ONAGI Statistics.